T19/78

TAXATION OF FOREIGN EARNED INCOME

NEWARK PUBLIC LIBRARY

DEC 15 1980

U. S. GOVT. PUBS.
DEPOSITORY 376

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

S. 2283

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 WITH RESPECT TO THE INCOME TAX TREATMENT OF EARNED INCOME OF CITIZENS OR RESIDENTS OF THE UNITED STATES EARNED ABROAD

S. 2321

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO EXEMPT FROM TAXATION THE EARNED INCOME OF CERTAIN INDIVIDUALS WORKING OUTSIDE THE UNITED STATES

S. 2418

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO INCREASE THE COMPETITIVENESS OF AMERICAN FIRMS OPERATING ABROAD AND TO HELP INCREASE MARKETS FOR UNITED STATES EXPORTS

JUNE 26, 1980

Printed for the use of the Committee on Finance

Y4.F49:

TAXATION OF FOREIGN EARNED INCOME

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

S. 2283

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 WITH RESPECT TO THE INCOME TAX TREATMENT OF EARNED INCOME OF CITIZENS OR RESIDENTS OF THE UNITED STATES EARNED ABROAD

S. 2321

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO EXEMPT FROM TAXATION THE EARNED INCOME OF CERTAIN INDIVIDUALS WORKING OUTSIDE THE UNITED STATES

S. 2418

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO INCREASE THE COMPETITIVENESS OF AMERICAN FIRMS OPERATING ABROAD AND TO HELP INCREASE MARKETS FOR UNITED STATES EXPORTS

JUNE 26, 1980

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE
67-448 O WASHINGTON : 1980 HG [illegible]

COMMITTEE ON FINANCE

RUSSELL B. LONG, Louisiana, *Chairman*

HERMAN E. TALMADGE, Georgia
ABRAHAM RIBICOFF, Connecticut
HARRY F. BYRD, Jr., Virginia
GAYLORD NELSON, Wisconsin
MIKE GRAVEL, Alaska
LLOYD BENTSEN, Texas
SPARK M. MATSUNAGA, Hawaii
DANIEL PATRICK MOYNIHAN, New York
MAX BAUCUS, Montana
DAVID L. BOREN, Oklahoma
BILL BRADLEY, New Jersey

ROBERT DOLE, Kansas
BOB PACKWOOD, Oregon
WILLIAM V. ROTH, Jr., Delaware
JOHN C. DANFORTH, Missouri
JOHN H. CHAFEE, Rhode Island
JOHN HEINZ, Pennsylvania
MALCOLM WALLOP, Wyoming
DAVID DURENBERGER, Minnesota

MICHAEL STERN, *Staff Director*
ROBERT E. LIGHTHIZER, *Chief Minority Counsel*

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

HARRY F. BYRD, Jr., Virginia, *Chairman*

LLOYD BENTSEN, Texas
HERMAN E. TALMADGE, Georgia
MIKE GRAVEL, Alaska

BOB PACKWOOD, Oregon
JOHN H. CHAFEE, Rhode Island
MALCOLM WALLOP, Wyoming

best copy available

CONTENTS

ADMINISTRATION WITNESSES

Page

Dickey, Robert, chairman, 911-913 Task Force the President's Export Council 79

Lubick, Hon. Donald C., Assistant Secretary for tax policy, Department of Treasury 55

PUBLIC WITNESSES

American Chamber of Commerce in Venezuela, Thomas L. Hughes, director and past president 206

American Citizens Abroad, Andrew Sundberg, director 407

American Express Co., Mark Cohen, vice president and general tax council 200

Arthur Andersen & Co., Melchior S. Morrione, head of expatriate tax practice 344

Asia-Pacific Council of American Chambers of Commerce, George H. Liesenberg, chairman, tax committee 202

Association of American Chambers of Commerce of Latin America, Alexander Perry Jr., president 204

Barnard, John H., vice president, Bechtel Power Corp 99

Bechtel Power Corp., John H. Barnard, vice president 99

Chase Econometrics, Robert Shriner 158

Cohen, Mark, vice president and general tax council, American Express Co 200

Conklin, Roger D., president, Cook Electric International Inc 459

Cook Electric International Inc., Roger D. Conklin, president 459

Council of American Chambers of Commerce, Milan F. Ondrus, chairman 201

Culpepper, Fred C., president, U.S. Overseas Tax Fairness Committee, Inc 109

Deloitte, Haskins & Sells, L. W. Linch 340

Enserch Corp., William T. Satterwhite, senior vice president and general council 426

Fisher, Larry, Fluor Corp 163

Fluor Corp., Larry Fisher 163

Frenzel, Hon. Bill, a U.S. Representative from the State of Minnesota 71

Grove Overseas Corp., Neil W. Krumweide, president 464

Hart, Peter J., national director of tax policy, Price Waterhouse & Co 341

Henderson, John, senior vice president, Textron Corp 423

Hercules East Group, Richard A. Leonard, president 465

Hughes, Thomas L., director and past president, American Chamber of Commerce in Venezuela 206

Jepsen, Hon. Roger, a U.S. Senator from the State of Iowa 31

Krumweide, Neil W., president, Grove Overseas Corp 464

Leonard, Richard A., president, Hercules East Group 465

Liesenberg, George H., chairman tax committee, Asia-Pacific Council of American Chambers of Commerce 202

Linch, L. W., Deloitte, Haskins & Sells 340

Morrione, Melchior S., head of expatriate tax practice, Arthur Andersen & Co 344

Ondrus, Milan F., chairman, Council of American Chambers of Commerce, Europe and Mediterranean 201

Perry, Alexander Jr., president, Association of American Chambers of Commerce in Latin America 204

Price Waterhouse & Co., Peter J. Hart, national director of tax policy 341

R. J. Reynolds Industries, Inc., C. Jackson Sink, director of domestic tax administration 424

Ralph M. Parsons Co., Joseph Volpe, vice president 462

Royer, Hon. William, a U.S. Representative from the State of California 74

Page
Satterwhite, William T., senior vice president and general council, Enserch Corp. 426
Shriner, Robert, Chase Econometrics 158
Sink, C. Jackson, director of domestic tax administration, R. J. Reynolds Industries, Inc 424
Sundberg, Andrew, director, American Citizens Abroad 407
Symms, Hon. Steven D., a U.S. Representative from the State of Idaho 73
Taxation with Representation, Victor Thuronyi, legislative director 188
Textron Corp., John Henderson, senior vice president 423
Thuronyi, Victor, legislative director, Taxation With Representation 188
U.S. Overseas Committee Inc., Fred C. Culpepper, president 109
Volpe, Joseph, vice president, Ralph M. Parsons Co 462

COMMUNICATIONS

American Constituency Overseas, George E. Fischer, chairman 593
Association for the Advancement of International Education, J. P. Janetatos 612
Deloitte Haskins & Sells 623
Fischer, George E., chairman, American Constituency Overseas 593
Fredricks, Henery 763
Henry, Sanford G 652
Janetatos, J. P., Association for the Advancement of International Education 612
Jones, Paul A., senior staff vice president, Kimberly-Clark Corp 609
Kimberly-Clark Corp., Paul A. Jones, senior staff vice president 609
Kirby, Robert E., Westinghouse Electric Corp 596
Milre, Jennifer D 681
National Ocean Industries Association, Carl L. Savit 605
Savit, Carl L., National Ocean Industries Association 605
TRW Inc., Peter F. Warker, director international affairs 619
Warker, Peter F., director international affairs, TRW Inc 619
Westinghouse Electric Corp., Robert E. Kirby 596

ADDITIONAL INFORMATION

Committee press release 2
Text of the bills S. 2283, S. 2321, and S. 2418 4, 13, 18
Opening statement of Senator Lloyd M. Bentsen 29
Opening statement of Senator Dole 29
An article by Gene A. Knoor from Tax Executive magazine 34

READEX FICHE

TAXATION OF FOREIGN EARNED INCOME

THURSDAY, JUNE 26, 1980

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2221, Dirksen Senate Office Building, the Honorable John H. Chafee presiding.

Present: Senators Chafee and Bentsen.

[The press release announcing this hearing, the bills S. 2283, S. 2321, S. 2418, and the opening statements of Senators Bentsen and Dole follow:]

Press Release #H-30

PRESS RELEASE

FOR IMMEDIATE RELEASE
June 4, 1980

COMMITTEE ON FINANCE
UNITED STATES SENATE
SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT
2227 DIRKSEN SENATE OFFICE BLDG.

FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT SETS HEARINGS ON THE TAXATION OF FOREIGN EARNED INCOME

Senator Harry F. Byrd, Jr., Chairman of the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance announced today that the Subcommittee will hold a hearing on Thursday, June 26, 1980, on three tax bills.

The hearing will begin at 2:00 P.M. in Room 2221 of the Dirksen Senate Office Building.

The following measures of general application will be considered. Revenue estimates on these measures will be provided at the time of the hearings.

S. 2283 -- Introduced by Senator Chafee. Would provide an annual exclusion of $50,000 for foreign earned income. People who are bona fide residents of a foreign country for at least three consecutive years would be permitted to exclude up to $65,000 per year. In addition, a special exemption for housing allowances in excess of 20 percent of earned income would be provided.

S. 2418 -- Introduced by Senator Bentsen. Would provide an annual exclusion of up to $60,000 for foreign earned income. The deduction for certain housing expenses under section 913 of the Code would be retained and the tax treatment under section 119 of lodging furnished to employees living in camps would also be modified.

S. 2321 -- Introduced by Senator Jepsen. Would provide that all foreign earned income of certain individuals is exempt from taxation.

Witnesses who desire to testify at the hearing must submit a written request, including a mailing address and phone number, to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D. C. 20510, by no later than the close of business on June 17, 1980.

Consolidated Testimony.--Senator Byrd also stated that the Committee urges all witnesses who have a common position or with the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Committee. This procedure will enable the Committee to receive a wider expression of views than it might otherwise obtain. The Chairman urged very strongly that all witnesses exert a maximum effort, taking into account the limited advance notice, to consolidate and coordinate their statements.

Legislative Reorganization Act.--Senator Byrd stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) A copy of the statement must be filed by noon the day before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 100 copies must be submitted by the close of business the day before the witness is scheduled to testify.

(4) Witnesses are not to read their written statements to the Subcommittee, but are to confine their oral presentations to a summary of the points included in the statement.

Written Statements.--Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record of the hearings. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Michael Stern, Staff Director, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D. C. 20510, not later than July 11, 1980.

P.R. #H-30

96TH CONGRESS
2D SESSION

S. 2283

To amend the Internal Revenue Code of 1954 with respect to the income tax treatment of earned income of citizens or residents of the United States earned abroad.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 8 (legislative day, JANUARY 3), 1980

Mr. CHAFEE introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 with respect to the income tax treatment of earned income of citizens or residents of the United States earned abroad.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. PARTIAL EXCLUSION FOR EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES.

(a) IN GENERAL.—Section 911 of the Internal Revenue Code of 1954 (relating to income earned by individuals in certain camps) is amended to read as follows:

"**SEC. 911. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES.**

"(a) GENERAL RULE.—In the case of an individual who is—

"(1) BONA FIDE RESIDENT OF FOREIGN COUNTRY.—A citizen of the United States and who establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, or

"(2) PRESENCE IN FOREIGN COUNTRY FOR 17 MONTHS.—A citizen or resident of the United States and who, during any period of 18 consecutive months, is present in a foreign country or countries during at least 510 full days in such period,

There shall be excluded from gross income and exempt from taxation under this subtitle amounts received from sources within a foreign country or countries (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during the period of bona fide residence or during the 18-month period, whichever is appropriate.

"(b) DEFINITION OF EARNED INCOME.—For purposes of this section, the term 'earned income' means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

"(c) Special Rules.—For the purpose of computing the amount excludable under subsection (a)—

"(1) Limitations on amount of exclusion.—The amount excluded from the gross income of an individual under subsection (a) for any taxable year shall not exceed an amount computed on a daily basis at an annual rate of—

"(A) $50,000, or

"(B) $65,000, in the case of an individual described in subsection (a)(1), but only with respect to that portion of such taxable year occurring after the individual has been a bona fide resident of a foreign country or countries for an uninterrupted period of 3 consecutive years.

"(2) ATTRIBUTION TO YEAR IN WHICH SERVICES ARE PERFORMED.—For purposes of applying paragraph (1), amounts received shall be considered received in the taxable year in which the services to which the amounts are attributable are performed.

"(3) TREATMENT OF COMMUNITY INCOME.—In applying paragraph (1) with respect to amounts received from services performed by a husband or wife which are community income under community property laws applicable to such income, the aggregate amount excludable, under subsection (a) from the gross income of such husband and wife shall equal the amount which would be excludable if such amounts did not constitute such community income.

"(4) REQUIREMENT AS TO TIME OF RECEIPT.—No amount received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed may be excluded under subsection (a).

"(5) CERTAIN AMOUNTS NOT EXCLUDABLE.—No amount—

"(A) received as a pension or annuity, or

"(B) included in gross income by reason of section 402(b) (relating to taxability of beneficiary of non-exempt trust), section 403(c) (relating to taxability of beneficiary under a nonqualified annuity), or section 403(d) (relating to taxability of beneficiary under certain forfeitable contracts purchased by exempt organizations),

may be excluded under subsection (a).

"(6) TEST OF BONA FIDE RESIDENCE.—A statement by an individual who has earned income from sources within a foreign country to the authorities of that country that he is not a resident of that country, if he is held not subject as a resident of that country to the income tax of that country by its authorities with respect to such earnings shall be conclusive evidence with respect to such earnings that he is not a bona fide resident of that country for purposes of subsection (a).

"(7) FOREIGN TAXES PAID ON EXCLUDED INCOME NOT CREDITABLE OR DEDUCTIBLE.—An individual shall not be allowed as a deduction or as a credit against the tax imposed by this chapter any credit for the amount of taxes paid or accrued to a foreign country or possession of the United States, to the extent that such deduction or credit is properly allocable to or chargeable against amounts excluded from gross income under this subsection, other than the deduction allowed by section 217 (relating to moving expenses).

"(d) HOUSING ALLOWANCE.—

"(1) IN GENERAL.—In the case of an individual described in subsection (a), there shall be excluded from gross income, and exempt from taxation under this subtitle, in addition to any amounts excluded and exempt under subsection (a) the greater of—

"(A) the amount by which such individual's housing allowance exceeds 20 percent of his earned income for the taxable year (determined without regard to such allowance), or

"(B) the amount by which such individual's housing costs exceed 20 percent of his earned income for the taxable year (as so determined).

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) HOUSING ALLOWANCE.—The term 'housing allowance' means—

"(i) an amount paid to the individual by his employer which is designated by the employer as paid for the purpose of defraying the individual's housing costs during the period during which such individual is outside the United States, or

"(ii) compensation from sources without the United States in the form of the right to use property or facilities,

but does not include any amount paid by the United States or any agency thereof or any amount to the extent that such amount is lavish or extravagant under the circumstances.

"(B) HOUSING EXPENSES.—The term 'housing expenses' means the reasonable expenses paid or incurred during the taxable year by or on behalf of an individual for housing for the individual (and, if they reside with him, for his spouse and dependents) in a foreign country. The term—

"(i) includes expenses attributable to the housing (such as utilities and insurance), but

"(ii) does not include interest and taxes of the kind deductible under section 163 or 164 or any amount allowable as a deduction under section 216(a).

"(3) SPECIAL RULE FOR SECOND FOREIGN HOUSEHOLD.—If an individual described in subsection (a) maintains a separate household outside the United States for his spouse and dependents and they do not reside with him because of living conditions which are dangerous, unhealthful, or otherwise adverse, then the words 'if they reside with him' in paragraph (2)(B) shall be disregarded.

(b) CLERICAL AMENDMENTS.—

(1) The table of sections for subpart B of part III of subchapter N of chapter 1 of such Code is amended by striking out the item relating to section 911 and inserting in lieu thereof the following:

"Sec. 911. Earned income from sources without the United States.".

(2) Sections 43(c)(1)(B), 1302(b)(2)(A)(i), 1304(b)(1), 1402(a)(8), 6012(c), and 6091(b)(1)(B)(iii) are each amended by striking out "relating to income earned by employees in certain camps" and inserting in lieu thereof "relating to earned income from sources without the United States".

SEC. 2. REPEAL OF DEDUCTION FOR CERTAIN EXPENSES OF LIVING ABROAD.

(a) IN GENERAL.—Section 913 of the Internal Revenue Code of 1954 (relating to deduction for certain expenses of living abroad) is hereby repealed.

(b) CONFORMING AMENDMENTS.—

(1) The table of sections for subpart B of part III of subchapter N of chapter 1 of such Code is amended by striking out the item relating to section 913.

(2) Section 62 of such Code (relating to definition of adjusted gross income) is amended by striking out paragraph (14).

SEC. 3. EFFECTIVE DATE.

(a) GENERAL RULE.—Except as provided in subsection (b), the amendments made by this Act shall apply with respect to taxable years beginning after December 31, 1979.

(b) ELECTION OF PRIOR LAW.—

(1) A taxpayer may elect not to have the amendments made by this Act apply with respect to any taxable year beginning after December 31, 1977, and before January 1, 1980.

(2) An election under this subsection shall be filed with the taxpayer's timely filed return for the first taxable year beginning after December 31, 1978.

○

96TH CONGRESS
2D SESSION

S. 2321

To amend the Internal Revenue Code of 1954 to exempt from taxation the earned income of certain individuals working outside the United States.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 20 (legislative day, JANUARY 3), 1980

Mr. JEPSEN introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to exempt from taxation the earned income of certain individuals working outside the United States.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. EXCLUSION OF EARNED INCOME FROM SOURCES OUTSIDE THE UNITED STATES.

(a) GENERAL RULE.—The section heading and subsection (a) of section 911 of the Internal Revenue Code of 1954 (relating to income earned by individuals in certain camps) is amended to read as follows:

"SEC. 911. EARNED INCOME FROM SOURCES OUTSIDE THE UNITED STATES.

"(a) GENERAL RULE.—The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

"(1) BONA FIDE RESIDENT OF FOREIGN COUNTRY.—In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such uninterrupted period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

"(2) PRESENCE IN FOREIGN COUNTRY FOR 17 MONTHS.—In the case of an individual citizen or resident of the United States who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such 18-month period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

An individual shall not be allowed as a deduction from his gross income any deduction, or as a credit against the tax imposed by this chapter any credit for the amount of taxes paid or accrued to a foreign country or possession of the United States, to the extent that such deduction or credit is properly allocable to or chargeable against amounts excluded from gross income under this subsection, other than the deduction allowed by section 217 (relating to moving expenses)."

(b) ELIMINATION OF LIMITATIONS ON AMOUNT OF EXCLUSION.—Subsection (c) of section 911 of such Code (relating to limitations and special rules) is amended—

(1) by striking out paragraphs (1), (2), (3), and (7), and

(2) by redesignating paragraphs (4), (5), and (6) as paragraphs (1), (2), and (3), respectively.

(c) REPEAL OF SECTION 913.—Section 913 of such Code (relating to deduction for certain expenses of living abroad) is hereby repealed.

(d) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) The table of sections for subpart B of part III of subchapter N of chapter 1 of such Code is amended—

(A) by striking out the item relating to section 911 and inserting in lieu thereof the following:

"Sec. 911. Earned income from sources outside the United States.", and

(B) by striking out the item relating to section 913.

(2) Sections 43(c)(1)(C), 1302(b)(2)(A)(i), 1304(b)(1), 1402(a)(8), 6012(c), and 6091(b)(1)(B)(iii) of such Code are each amended by striking out "relating to income earned by employees in certain camps" and inserting in lieu thereof "relating to earned income from sources outside the United States".

(3) Subsection (k) of section 1034 of such Code (relating to an individual whose tax home is outside the United States) is amended—

(A) by striking out "(as defined in section 913(j)(1)(B))", and

(B) by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, the term 'tax home' means, with respect to any individual, such individual's home for purposes of section 162(a)(2) (relating to travel expenses while away from home); except that an individual shall not be treated as having a tax home in a foreign country for any period for which his abode is within the United States."

(4) Subsection (a) of section 3401 of such Code (defining wages) is amended by striking out the paragraph (18) which was added by section 207(a) of the Foreign Earned Income Act of 1978.

(5) Clause (iii) of section 6091(b)(1)(B) of such Code is amended by striking out "section 913 (relating to deduction for certain expenses of living abroad)".

SEC. 2. EFFECTIVE DATE.

The amendments made by section 1 of this Act shall apply to taxable years beginning after December 31, 1980.

○

96TH CONGRESS
2D SESSION

S. 2418

To amend the Internal Revenue Code of 1954 to increase the competitiveness of American firms operating abroad and to help increase markets for United States exports.

IN THE SENATE OF THE UNITED STATES

MARCH 12 (legislative day, JANUARY 3), 1980

Mr. BENTSEN introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to increase the competitiveness of American firms operating abroad and to help increase markets for United States exports.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. EXCLUSION FROM GROSS INCOME.

Section 911 of the Internal Revenue Code of 1954 (relating to income earned by individuals in certain camps) is amended to read as follows:

"SEC. 911. PARTIAL EXCLUSION FROM GROSS INCOME FOR INCOME EARNED ABROAD.

"(a) GENERAL RULE.—The following items shall, at the election of the taxpayer, not be included in gross income and shall be exempt from taxation under this subtitle:

"(1) BONA FIDE RESIDENT OF FOREIGN COUNTRY.—In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts which constitute earned income attributable to services performed during such interrupted period, except amounts paid by the United States or any agency thereof. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

"(2) PRESENCE IN FOREIGN COUNTRY FOR 11 MONTHS.—In the case of an individual citizen or resident of the United States who during any period of 12 consecutive months is present in a foreign country or countries at least 330 full days in such period, amounts which constitute earned income attributable to services performed during such 12-month period except amounts paid by the United States or any agency thereof. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

"(3) WAIVER OF PERIOD OF STAY IN FOREIGN COUNTRY.—For purposes of paragraphs (1) and (2) of this subsection, an individual who for any period is a bona fide resident of or is present in a foreign country and who—

"(A) leaves such foreign country—

"(i) during any period during which the Secretary determines, after consultation with the Secretary of State or his delegate, that individuals were required to leave such foreign country because of war, civil unrest, or similar adverse conditions in such foreign country which precluded the normal conduct of business by such individuals, and

"(ii) before meeting the requirements of such paragraphs (1) and (2), and

"(B) establishes to the satisfaction of the Secretary that he could reasonably have been expected to have met such requirements, shall be treated as having met such requirements with respect to that period during which he was a bona fide resident or was present in the foreign country.

"(C) This paragraph shall apply only with respect to periods an individual was a bona fide resident of or present in a foreign country and did not meet the requirements of section 911(a) (1) or (2) of the Internal Revenue Code of 1954 with respect to such periods because he left the foreign country after September 1, 1978.

An individual who elects the exclusion provided by this subsection shall not be allowed as a deduction from his gross income or as a credit against the tax imposed by this chapter any credit for the amount of taxes paid or accrued to a foreign country or possession of the United States, to the extent that such deduction or credit is properly allocable to or chargeable against amounts excluded from gross income, other than deductions allowed by section 217 (relating to moving expenses).

"(b) DEFINITION OF EARNED INCOME.—For purposes of this section, the term 'earned income' means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

"(c) SPECIAL RULES.—For purposes of computing the amount excludable under subsection (a), the following rules shall apply:

"(1) LIMITATION ON AMOUNT OF EXCLUSION.—The amount excluded from the gross income of an individual under subsection (a) for any taxable year shall not exceed an amount which shall be computed on a daily basis at an annual rate of $60,000 for the period during which he qualifies.

"(2) ATTRIBUTION TO YEAR IN WHICH SERVICES ARE PERFORMED.—For purposes of applying paragraph (1), amounts received shall be considered received in taxable year in which the services to which the amounts are attributable are performed.

"(3) TREATMENT OF COMMUNITY INCOME.—In applying paragraph (1) with respect to amounts received from services performed by a husband or wife which are community income under community property laws applicable to such income, the aggregate amount excludable under subsection (a) from the gross income of such husband and wife shall equal the amount which would be excludable if such amounts did not constitute such community income.

"(4) REQUIREMENT AS TO TIME OF RECEIPT.—No amount received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed may be excluded under subsection (a).

"(5) CERTAIN AMOUNTS NOT EXCLUDABLE.—No amount—

"(A) received as a pension or annuity, or

"(B) included in gross income by reason of section 402(b) (relating to taxability of beneficiary of nonexempt trust), section 403(c) (relating to taxability of beneficiary under a nonqualified annuity), or section 403(d) (relating to taxability of beneficiary under certain forfeitable contracts purchased by exempt organizations),

may be excluded under subsection (a).

"(6) TEST OF BONA FIDE RESIDENCE.—A statement by an individual who has earned income from sources within a foreign country to the authorities of that country that he is not a resident of that country, if he is held not subject as a resident of that country to the income tax of that country by its authorities with respect to such earnings, shall be conclusive evidence with respect to such earnings that he is not a bona fide resident of that country for purposes of subsection (a)(1).

"(d) CROSS REFERENCES.—

"(1) For administrative and penal provisions relating to the exclusion provided for in this section, see sections 6001, 6011, 6012(c), and the other provisions of subtitle F.

"(2) For elections as to treatment of income subject to foreign community property laws, see section 981.".

SEC. 2. EMPLOYEES LIVING IN CAMPS.

Section 119 of the Internal Revenue Code of 1954 is amended by adding the following new subsection:

"(c) EMPLOYEES LIVING IN CAMPS.—In the case of an individual who is furnished lodging in a camp, such camp shall be considered to be part of the business premises of the employer. For purposes of this section a camp constitutes lodging which is—

"(1) provided by or on behalf of the employer because the place at which such individual renders services is in an area where satisfactory housing is not available on the open market,

"(2) located as near as practicable, in the vicinity of the place at which such individual renders services, and

"(3) furnished in a common area (or enclave) which is not available to the public.".

SEC. 3. DEDUCTION FOR CERTAIN HOUSING EXPENSES.

Section 913 of the Internal Revenue Code of 1954 is amended to read as follows:

"SEC. 913. DEDUCTION FOR CERTAIN HOUSING EXPENSES OF LIVING ABROAD.

"(a) ALLOWANCE OF DEDUCTION.—In the case of an individual who is—

"(1) BONA FIDE RESIDENT OF FOREIGN COUNTRY.—A citizen of the United States and who establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, or

"(2) PRESENCE IN FOREIGN COUNTRY FOR 11 MONTHS.—A citizen or resident of the United States and who during any period of 12 consecutive months is present in a foreign country or countries during at least 330 full days in such period.

there shall be allowed as a deduction for such taxable year or for any taxable year which contains part of such period, the qualified housing expenses set forth in subsection (b).

"(b) QUALIFIED HOUSING EXPENSES.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified housing expenses' means the excess of—

"(A) the individual's housing expenses, over

"(B) the individual's base housing amount.

"(2) HOUSING EXPENSES.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'housing expenses' means the reasonable expenses paid or incurred during the taxable year by or on behalf of the individual for housing for the individual (and, if they reside with him, for his spouse and dependents) in a foreign country. Such term—

"(i) except as provided in clause (ii), includes expenses attributable to the housing (such as security, utilities, and insurance), and

"(ii) does not include interest and taxes of the kind deductible under section 163 and 164 or any amount allowable as a deduction under section 216(a).

"(B) Portion which is lavish or extravagant not allowed.—For purposes of subparagraph (A), housing expenses shall not be treated as reasonable to the extent such expenses are lavish or extravagant under the circumstances.

"(3) Base housing amount.—For purposes of paragraph (1) the term "base housing amount" means 16 percent of the salary of an employee of the United States whose salary grade is step 1 of grade GS-14, said salary amount to be calculated on a daily basis for the period determined in accordance with paragraph (4)(B) of this subsection.

"(4) Periods taken into account.—

"(A) In general.—The expenses taken into account under this subsection shall be only those which are attributable to housing during periods for which—

"(i) the individual's tax home is in a foreign country, and

"(ii) the value of the individual's housing is not excluded under section 119.

"(B) Determination of base housing amount.—The base housing amount shall be determined for the periods referred to in subparagraph (A).

"(5) ONLY ONE HOUSE PER PERIOD.—If, but for this paragraph, housing expenses for any individual would be taken into account under paragraph (2) of subsection (b) with respect to more than one abode for any period, only housing expenses with respect to that abode which bears the closest relationship to the individual's tax home shall be taken into account under such paragraph (2) for such period.

"(c) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing rules—

"(1) for cases where a husband and wife each have earned income from sources outside the United States, and

"(2) for married individuals filing separate returns.".

SEC. 4. EFFECTIVE DATE.

The amendments made by this Act shall apply with respect to taxable years beginning after December 31, 1979.

○

OPENING STATEMENT OF SENATOR LLOYD M. BENTSEN

Like many of you here today I am concerned about the extent to which this country—alone among major world trading nations—seems determined to place obstacles in the path of our exports.

International trade is an extremely competitive business where a thin margin can make a vital difference. The country that accepts a competitive disadvantage is going to have a hard time making it up.

Our competitors for world markets generally have comprehensive trade policies . . . they recognize the iron link between exports and domestic prosperity . . . and the Government, the private sector, and labor frequently work together in the search for export opportunities.

That, unfortunately, is not the case in America, and perhaps it is one reason for our huge and chronic trade deficits which debase the value of our currency abroad, fan the fires of inflation in this country, and raise real doubts about our ability to compete for world markets.

Like Senator Chafee, I am concerned about the manner in which this country taxes its businessmen overseas, its frontline troops in the battle for exports. There is no other major trading nation that places a similar tax burden on its nationals working abroad. As a result of our tax policies it is becoming prohibitively expensive to station American commercial representatives in vital foreign markets. We are relying increasingly on third country nationals to market our products.

With a trade deficit that might well exceed $40 billion this year, this country can no longer afford unilateral restraints or disincentives on its ability to export. Section 911 of the Tax Code is one such disincentive, and I hope we can make some changes in this area—changes for the better. Changes that will encourage a stronger, more dynamic American commercial presence abroad.

That is the purpose of our hearings today, and I look forward to hearing your testimony.

STATEMENT OF SENATOR DOLE

Mr. Chairman, I would like to go on record in support of Senator Chafee's bill, S. 2283.

We are at a point in time in which America cannot afford to withdraw into a shell. Rather, we must move forward, particularly in the economic sphere, to counter the appearance of declining American prestige in the eyes of the world. In keeping with this idea I believe that we must support, rather than hinder, American citizens working abroad.

The United States is the only major industrial country that taxes the earned income of its citizens working abroad. Those citizens are also subject to foreign income taxes. This policy impairs the competitive position of American companies. It hinders our ability to maintain highly qualified Americans in key positions overseas. This excessive tax burden often results in the lessening of job opportunities abroad for Americans. It is also an unwarranted restriction on American companies, which are being outbid on contracts.

Mr. Chairman, the Foreign Earned Income Act of 1978 was intended to alleviate this excessive tax burden. The intent was to allow expatriates to deduct reimbursements relating to excess foreign living costs. However, in practice the deductions allowed are significantly less than the actual reimbursement for such reasonable expenses that are granted by the companies involved. This results in higher tax liabilities for U.S. citizens working abroad.

The revenue effect of Senator Chafee's bill would be modest compared to the benefits to be realized. We should not forget that the high quality of work done by Americans overseas contributes greatly to the way we are viewed by the world. We must encourage a greater number of highly-skilled American workers to contribute to the world economy by working abroad. That is ample reason to support this additional tax relief for American expatriates.

Mr. Chairman, I thank you for scheduling this hearing in a timely fashion. I know that Senator Bentsen and Senator Jepsen also have very worthy proposals to deal with this problem, and I hope this forum will bring out the pros and cons of the different approaches.

Senator **CHAFEE**. Good afternoon, ladies and gentlemen. This is a meeting of the Subcommittee on Taxation and Debt Management, chaired by Senator Harry Byrd, under whose auspices the subcommittee is meeting today. Senator Byrd will not be here. I will be conducting the hearing, since it is in connection with a measure that I am extremely interested in, S. 2283, which I introduced last February, and which has 12 cosponsors.

At the same time, we will be considering a very similar measure introduced by Senator Jepsen which is S. 2321. It is a companion to a bill introduced in the House by Congressmen Frenzel. Next, we will look at S. 2418, sponsored by Senator Lloyd Bentsen, who, of course, is widely acknowledged as one of the Senate's most active and leading export policy proponents.

Now, I have a brief statement. Although these measures differ somewhat, they evidence a common concern that American industry is rapidly losing its competitive edge around the world. One of the most graphic illustrations of this is the precipitous drop in the U.S. share of engineering and construction contracts in the Middle East. In this lucrative market, American firms are taking about a 1.5 percent share compared to a 10-percent share in 1976.

Now, there have been a lot of studies on these matters, such as one by the President's Export Council, headed by Mr. Reginald Jones, who is familiar to members of this committee and to many members of the audience here. The GAO and the Chase Econometrics have completed analyses of the restrictive post-1976 statute affecting the taxation of Americans abroad.

The analysis concluded that U.S. exports have declined at least 5 percent as a direct result of that legislation. Nevertheless, we are talking not only about lost business but also about tens, and perhaps hundreds, of thousands of export-related jobs here at home and millions, and perhaps billions, according to the Chase Econometrics study, in lost revenues.

Now, we recognize there are other factors involved besides solely the 911 and 913 tax provisions, but that is the one particular area that we will concentrate on today. It is the nearly unanimous opinion that these provisions have been a major problem to U.S. industries attempting to compete abroad. We will hear testimony today from both those who favor changes and from those who do not favor changes, and we will, of course, be hearing from the administration, represented by the Department of Treasury in the person of Mr. Lubick.

So, let me just say one other point that has come to my attention as I have studied this matter. We have spent a great deal of attention on lost jobs, lost exports, all in terms of dollars, but there is another facet that is not so quantifiable, and that is, I think, there is great merit in having Americans abroad, period, showing the flag, if you would, learning abroad, and bringing back ideas from abroad. These benefits are completely unrelated to the dollars and cents that increased exports might bring to the country.

Although the testimony today will not be concerned with that direct point, I just believe that it is in the best interests of our country to have Americans serving in far corners of this globe. Now, we are delighted to hear from Senator Bentsen, who has been so active in this field for many, many years, and, of course, he has introduced one of the measures we will be considering today: S. 2418.

Senator **Bentsen**. Thank you very much, Senator Chafee.

I certainly share the comments that you have made, and recognize the deep concern that you have had and the work that you have done.

What concerns me is, we seem to be alone among the major trading nations of the world in trying to really place obstacles in the path of our exports. International trade is an extremely competitive business, and if you give a thin edge to your competitors, obviously, you are going to have a hard time making it up.

Our competitors generally have comprehensive trade policies, and they recognize the iron link between exports and domestic prosperity. The Government and the private sector and labor have a tendency to work together in trying to improve exports, instead of the kind of adversary relationship that we see here.

Like Senator Chafee, I am concerned about the manner in which this country taxes its businessmen abroad, the frontline troops in the battle for exports. We took the Joint Economic Committee to the Far East. We had 9 days of continuous hearings, total emersion, day, morning, afternoon, and then in the evening they beat our ear, the same point being made over and over, that they could hire third-country nationals and keep them in their jobs a lot cheaper than they could hire American nationals abroad, but one set of testimony where they told us that if they paid a man $36,000 a year and if he was a third country national, it would cost a little over $60,000 a year to support him there, but if they hired an American national, it would cost almost $100,000.

Now, who do you think they are going to hire. If you have third-country nationals, they will go ahead and fill a contract from the company that employs them to the extent that that company produces those products, but if there are supplementary products, obviously, they go to the country that they are from, where they have confidence in the products, where they know the products.

There is no question but that we have lost a substantial amount of trade as American nationals have been driven home by the differential in the tax system, as we have seen with the competitors of other nations.

So, I am deeply concerned about the subject of these hearings, and I am very pleased to be here, joining with Senator Chafee, and seeing the responses and the testimony that is given as we try to improve this situation.

Senator CHAFEE. Now, gentlemen, we have quite a list of witnesses today. We will be divided up in panels. I would urge that the remarks of the various witnesses be kept to 5 minutes apiece in order that we have a chance for questions and in order that everybody would have an opportunity to be heard.

The first witness is our distinguished colleague from the State of Iowa, Senator Roger Jepsen, who, as was mentioned earlier, sponsored S. 2321, which is similar to the bill that Representative Bill Frenzel has introduced in the House. We welcome you, Senator Jepsen, and look forward to your testimony.

STATEMENT OF HON. ROGER JEPSEN, A U.S. SENATOR FROM THE STATE OF IOWA

Senator JEPSEN. Thank you, Mr. Chairman.

Thank you for the opportunity to testify before your subcommittee today in favor of S. 2321, a bill I have introduced to eliminate U. S. taxes on foreign-earned income of American citizens working abroad. As you stated, my bill is identical to H.R. 5211 introduced by Congressman Bill Frenzel of Minnesota last year.

My interest in this legislation stems from long conversations with Iowa exporters. Many people who think of Iowa only as a farm State are surprised to discover the important role which manufacturing plays in the State's economy.

In 1977, 240,000 people in Iowa were employed in manufacturing. The total value added by manufacturing for the State amounted to $8.7 billion. These manufacturing firms are very active in export markets. Approximately 20 percent of all Iowa's manufacturers export. This foreign trade employs thousands of Iowans and is an important factor in the State's prosperity.

Unfortunately, Iowa exporters, including, of course, those involved in agricultural exports as well, have encountered increasing difficulty in marketing their products overseas. One particularly onerous barrier is the tax barrier. Because of high U.S. taxes on Americans who work overseas, in addition to the high cost of living and high foreign taxes, it is very expensive to station U.S. personnel in foreign countries.

The Iowa Development Commission, for example, which works to help Iowa companies export their products, is able to maintain only one foreign office, in Frankfurt, West Germany, because the cost of sending additional Iowans to Europe is just prohibitive.

For too many years, the United States, as has been indicated earlier here by the Senator from Texas, has been unconcerned about developing foreign markets. The domestic U.S. market is so large that companies could grow quite large without having to sell their goods outside of the United States itself. Times have changed. We can't ignore the international marketplace any longer.

For one thing, our foreign competitors have taken over a substantial portion of the U.S. market from American firms. The automobile market is only the most obvious example. In response, many people are asking for tariffs, import quotas, and other trade protections for domestic industries. It would be a tragic mistake, in my opinion, for the United States to follow this route.

Ultimately, the United States would be a poorer country if measures are taken to restrict international trade.

The real answer is to meet foreign competition by developing our own export markets. As a nation we must become more trade oriented. We must work to remove trade impediments in the United States and in the international area. Passage of the Multilateral Trade Agreement last year was a big step forward, but more can be done.

As I said earlier, one totally unnecessary impediment to U.S. companies engaged in international trade is the excessive U.S. tax burden on Americans working abroad.

Mr. Chairman, at this time, in keeping with your admonishment that we keep the remarks within 5 minutes, I will try to make mine even briefer, and ask that the balance of my remarks be printed in the record as though read. I will just summarize by simply saying that I want to make sure that as we talk about my particular bill, we remember it is not that we want to escape taxes or that those folks, Americans who are working overseas, will not pay any taxes. The fact is and the problem is that unlike any other nation in the world, we have our American citizens who work overseas pay our taxes and they pay the taxes of the countries they work in, too, so they really have double taxation.

That in and of itself is discouraging many Americans from going overseas or taking any positions of expertise, technical or otherwise. I just had lunch with a gentleman who is a journalist, in fact works for AP, who had been on overseas assignment. He said AP was having a very tough time getting people to go overseas today; that unless you were a single person who was doing it for the love of adventure and so on, there is no way that they could get people to accept assignments overseas today.

I think even more important is the fact that when we don't have Americans working overseas, American companies that are bidding for contracts use people from other countries to work on their contracts. They also will then probably buy, and in fact do buy, equipment that those folks are used to handling, can repair, know how to run and how to operate.

The toll that that has taken on our economy, if we could have some source and could add it all up, I think we would find is staggering. I know one example of a company which has over a $20 billion contract. It is in the construction area, and I will leave the country unnamed. It doesn't make any difference. The principle is what is important. The facts are that this company, on this over $20 billion contract they have for construction, has two—two Americans, both in supervisory capacity, working on that, and all of the tractors, and all of the cranes, and all of the bulldozers, and all of the equipment, and all the powerplants, and motors, and so on, are all purchased from another nation.

This company would really prefer to do business in the country in which it is based, in the country in which the owners are citizens.

So, this is a very important bill. This is a very important hearing that you are having. I compliment and thank you for having it, and I do hope that it brings and bears fruit very quickly.

Thank you, Mr. Chairman.

Senator BENTSEN. Senator, I would like to insert at the appropriate point in the record an article from the Tax Executive magazine authored by Gene Knorr pointing out some of the policy problems inherent in the current law.

Senator CHAFEE. Fine.

[The following was subsequently supplied for the record:]

Foreign Earned Income--Policy Improved But Not Resolved

By GENE A. KNORR

Reprinted from The TAX EXECUTIVE
April, 1979

Copyright 1979 by Tax Executives Institute, Inc.
Arlington, VA

Foreign Earned Income--Policy Improved But Not Resolved

By GENE A. KNORR*

Late in 1978 Congress passed highly significant legislation governing taxation of U.S. citizens and residents working abroad. Called the Foreign Earned Income act of 1978 (P.L. 95-615), this legislation signaled an abrupt policy shift from the Tax Reform act of 1976 (P.L. 94-455), which severely curtailed benefits available under section 911 of the Internal Revenue code.

This reflected a dramatic turnaround from the 94th to the 95th Congress. It occurred because (1) restrictions in the Tax Reform act of 1976 (76 act), combined with new court decisions and stricter IRS enforcement of the pre-1976 law, were limiting employment of U.S. citizens overseas; (2) a record deficit in the U.S. balance of trade led to increased concern over tax policies that affect U.S. exports; and (3) affected taxpayers waged an intensive campaign to change the law.

---

* of Charls E. Walker Associates, Inc., economic consultants, Washington, D.C.

The Foreign Earned Income act of 1978 (78 act) represents a compromise between ofttimes conflicting considerations of tax equity and current perceptions of U.S. trade and export policy. Consequently, one may effectively analyze the act by tracing key policy objectives in the legislative history. Such analysis is timely because taxpayers, uncertain over results of the 1978 legislative effort, are focusing acute attention on the regulatory process. In making judgments about the 78 act and that regulatory process, one should also consider some of the political forces involved.

Three Continuing Issues

Since the United States taxes its citizens worldwide, basic issues in section 911 are (1) whether those working overseas should be treated the same as their U.S. counterparts; (2) if so, how is that equality achieved; and (3) if not, why is different treatment necessary? Answers to those questions, based on differing views of tax equity, U.S. trade and export policy, and the effectiveness of tax law to affect such policy, have been cast in radically different terms each time Congress readdressed these questions. During the first fifty years (1926-1976) of section 911, one priority of Congressional amendments was to prevent abuse. Congress has not clarified the policy issues recently, and Congressional statements between the 1976 and 1978 acts reflected great uncertainty. However, an analysis of the legislative history may help ascertain which policies control current law.

Legislative History of Section 911

Section 911 (or predecessors) has consistently excluded from gross income all or a specified amount of annual earned income from foreign employment of U.S. citizens. When the predecessor of section 911 was enacted in 1926, the excluded amount applied to all foreign income of citizens spending six months or more outside the U.S. in any year. Known as the foreign trader exemption, it was designed to benefit U.S. export salesmen (although statutory language made no such limitation).

During the 1926-1976 period, numerous amendments were made to the section. All generally limited the availability of the exclusion. For example, in 1932 government employes were excluded. In 1942, foreign residency for the taxable year became a requirement. In 1951, the residency requirement was relaxed by establishing an alternative physical presence test of 17 out of 18 consecutive months. In part to correct abuses under that test, a $20,000 limit on the excluded amount was enacted in 1953. In 1962, the amount excluded for bona fide foreign residents was limited to $20,000 for the first three years, and $35,000 per year thereafter. The $35,000 limit was lowered to $25,000 in 1964.

Tax Reform Act of 1976

Ways and Means Proposal

On the basis of equity, the House Ways and Means committee in 1975 called for a three-year phaseout of the 911 exclusion in H.R. 10612, which was to become the Tax Reform act of 1976. The committee reported that the exclusion was a tax advantage to citizens abroad as compared to those in the U.S., and that applying the foreign tax credit to the excluded amount was a double benefit.[1]

Without a clear definition, equity meant equality or comparability between taxpayers here and abroad. To that end, certain schooling expenses and municipal-type services, typically provided within the U.S. by state, local or federal government, were granted a special deduction.

Without analysis, the committee retained the $20,000 exclusion during the phaseout period for engineering and construction workers employed on overseas projects. The House passed these provisions without substantial change or debate.

Rostenkowski Task Force Efforts

In January 1976 the chairman of the House Ways and Means committee appointed ten members of the committee, with Dan Rostenkowski (D-Ill.) as chairman, to a special task force to study five troublesome issues of foreign taxation, including section 911. Because the 1926 act was not limited to Americans working for U.S. export companies, and because the Domestic International Sales Corporation (DISC) had been established to promote and sell exports, the task force called for phasing out the general exclusion. DISC and so-called deferral were also under attack in the 94th Congress, which contributed significantly to the downplaying of export issues on the 911 question.

The exclusion was retained for service and engineering firms, since if removed it would result in increased costs of operation abroad, preventing such companies from effectively competing with foreign companies. Fewer projects would be designed with U.S. parts and equipment. This is why the House bill gave special treatment to workers abroad promoting projects involving U.S. goods and services. The House passed the 1976 act before the task force completed its report,[2] and both must be studied to find reasons for House passage.

Senate Finance Role

The Senate Finance committee retained the exclusion "so that the competitive position of U.S. firms abroad is not jeopardized." Concerned about unintended results, however, the committee (1) removed the foreign tax credit on the excluded amount because it was a double benefit; (2) disallowed amounts received outside the foreign country in which earned if for tax avoidance reasons; and (3) taxed income in excess of the excluded amount at higher bracket rates, calling the current system inconsistent with our progressive tax system. A limited exclusion for costs of housing was allowed.[3] The Senate passed that bill without subtsantial amendment.

Thus, in 1976, the task force was willing to terminate the exclusion because it did not promote exports (except for service and construction firms); the House was willing to end it on the basis of equity; but the Senate retained it, apparently because of international competition. However, on the basis of equity, that is, comparability or equality with U.S. taxpayers stateside, the Senate chose to correct some unintended results, and trimmed significantly the usefulness of section 911.

The Conference Product

As finally agreed in conference between the House and Senate, the Tax Reform act of 1976 increased taxes substantially for Americans working abroad and their employers. The $20,000 exclusion became $15,000, and the Senate limitations on the usefulness of the exclusion were enacted.

Foreign Earned Income Act of 1978

The Forces at Work

In the mid-seventies the expatriate community was not organized to respond to Congressional initiatives. It had been under increasing pressure because of adverse court decisions and stricter IRS enforcement which swept into income the local fair market value of exorbitant living costs abroad. However, passage of the 1976 act was the catalyst that caused the expatriate community to organize and work for new legislation. An intense lobbying effort erupted, engaged in by American expatriates, their employers, business groups, the engineering and construction industries, chamber of commerce organizations from around the world, and a number of ad hoc groups organized to seek redress from the 1976 law.

Costs of doing business abroad were rising dramatically; companies were being forced to forego Americans and hire foreign nationals, and projects were being lost to foreign competition. Since the 1976 act had been made retroactive to pick up additional revenue, the first priority was to secure a delay in the effective date. A one-year delay, to January 1, 1977, was enacted in 1977. However, taxpayers wanted certainty in tax treatment, which could only come with a final legislative solution.

The engineering and construction industry, singled out in the task force report, wanted Congress to recognize their special importance to export goals of the U.S. The industry's aggressive stance was based in part on a belief that in the bargaining over the 1976 act, supporters of a liberal section 911 had been outgunned by large multinational organizations fighting for full retention of the foreign tax credit, deferral of taxes on foreign income, and DISC—all at the expense of section 911.

Business was not of one mind on section 911 issues. Multinational companies producing goods for export, service supply companies, petroleum equipment suppliers, regional chambers of commerce, and individual expatriates had differing views on how legislation should be drafted. Since engineering and construction firms and equipment supply firms operating in the Middle East and Southeast Asia were facing the most dramatic inflation and cost increases, they took a lead in explaining the competitive problems abroad. However, the respective lobbying groups maintained close coordination.

As to the IRS and recent court decisions, it was argued that neither tax equity nor neutrality was served in taxing workers on income for which they received no economic benefit. Moreover, the 1976 act would increase the cost of employing Americans abroad. American firms abroad would be less competitive, resulting in decreased exports and fewer jobs for Americans here and abroad. This would impact adversely on important national goals: (1) maintaining balance in our international accounts, (2) continuing an essential United States presence abroad, and (3) promoting economic progress in both the developing and industrial worlds.[4] Because of a record trade deficit of about $27 billion in 1977, at no previous time had considerations of trade and export policy been so important in international tax issues.

Never before were these arguments so relentlessly pushed on Congress by the affected taxpayers. This included visits from company officers and expatriates, Washington counsel, and a grassroots campaign reaching most of the key legislators in their home districts. Lawmakers grew weary of the issue and the pressure for change.

Without this combination of heightened policy concern, plus intense public pressure, the 1978 act would not have granted the relief it did.

Treasury's Report

In February of 1978 the Treasury department published a report[5] which discussed revenue aspects of section 911 and alternative approaches. However, the study did not focus on policy considerations of export and trade. That omission was one of the document's critical failures.[6]

While citing large dollar amounts as the static revenue or tax expenditure cost of section 911 ($498 million under 1975 law), the Treasury admitted that it could not effectively take into account secondary or feedback effects. That is a classic problem with such estimates, which assured that the figures on section 911 were substantially in error.

Feedback cannot be ignored where it is reasonable to assume affected taxpayers will change their conduct because of higher tax impact. For example, George P. Shultz,[7] President of Bechtel Corporation, argued that the second order effect of increased taxes would be significant, since stricter IRS enforcement and the threat of the 1976 act were placing severe pressure on U.S. companies to substitute foreign workers and technicians in overseas projects. U.S. companies could not compete in the intensified international market against highly competitive and sophisticated foreign companies whose labor cost was lower because of moderate or non-existent tax on workers. This was particularly acute in cost-plus contracts, because foreign clients would not accept increased U.S. tax costs as a necessary added expense.

There was also a ripple effect. Returning workers would add to the U.S. unemployment problem. Lost foreign business would result in lower direct taxes on U.S. overseas business. Lessened U.S. support work for foreign projects meant lost U.S. taxes on workers and companies within the United States. Goods would no longer be pulled from U.S. suppliers of the foreign projects. This would affect U.S. manufacturing companies, export sales companies, dockworkers, and shipping companies.[8]

Because of the above, it was reasonable that higher taxes would severely erode the tax base. Therefore, since no second order or ripple effect had been considered, the revenue costs discussd in the Treasury study were in error. It followed that the issue should be decided on broader, national U.S. goals, not revenue cost.

Administration's Internal Differences

The administration recommended that the exclusion be repealed, and that a series of deductions be granted to cover (1) excess housing costs, (2) certain elementary and secondary education expenses subject to a ceiling, and (3) home leave costs every other year. In addition, the moving expense deduction and section 119, the construction camp provisions, would be liberalized.[9]

Policy officials at Treasury disagreed on the section 911 issue. For example, the Assistant Secretary for Tax Policy, appearing before the House Ways and Means committee in February 1978, did not discuss considerations of trade and export policy.[10] This reflected the administration position which it was understood had been decided earlier that morning at the Presidential level.

By contrast, less than three months later, in testimony before the Senate Finance committee, the Under Secretary of the Treasury for Monetary Affairs said, "This administration also recognizes that our tax policy regarding overseas Americans has important consequences for our trade interests." [11]

Noting that the U.S. is the only major country that taxes the income of its non-resident citizens, the Under Secretary said that when additional earnings necessary to attain a standard of living comparable to the U.S. are taxed, it "may place our citizens overseas in a worse position than they would have been had they remained in the United States." This is the equity argument, but without more, he considered it no more compelling than differences in costs of living within the U.S. "But when these issues of equity," continued the Under Secretary, "are combined with the competitive realities facing many overseas Americans, special consideration seems advisable." [12]

This illustrates the difference in viewpoint within the Treasury department between tax policy officials and those charged with trade ond balance-of-payments policy. Although each supported an administration recommendation granting certain deductions for excess living costs, one based the arguments on tax equity, and the other on trade, exports and international competition. If the administration's recommendations to the House satisfied the definition of equity, i.e., keeping a taxpayer whole, then it would seem a broader legislative draft was necessary to achieve the special consideration cited in the Senate testimony. Unfortunately that was not the case, even though in another study released by the Treasury (too late to have an impact on the legislative process), the analysis seemed to confirm that "Americans abroad . . . appear to be an important determinant of U.S. exports." [13]

Comptroller General's Concern With Incentives

The GAO released a report in February 1978 entitled Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas. In testimony before the Senate Finance Committee reporting on that study, the Comptroller General stated:

> . . ., because of the seriousness of the deteriorating U.S. international economic position, the relatively few policy instruments now available for promoting U.S. exports and commercial competitiveness abroad, we recommend continuing section 911-type incentives at least until more effective policy instruments are identified and implemented.
>
> Our concern is based upon a fundamental belief that, to maintain and build upon the competitive position of the United States, it is essential for a large force of U.S. citizens to be maintained abroad to promote and service U.S. products and operations.[14]

The GAO criticized the Treasury recommendation because it contained no cost of living deduction, and did not provide a specific incentive for Americans to work overseas.[15]

At this point, it appeared as if standards of tax equity and static revenue cost figures had been overtaken by arguments for export incentives to bolster the international competitiveness of U.S. firms.[16]

Senate Emphasis On Equity

After making a trip abroad and hearing firsthand the complaints of U.S. expatriates over the 1976 act, Senator Abraham Ribicoff (D-Conn.), a member of the Senate Finance committee, tried to rectify the section 911 problems. He introduced a bill that set aside the old exclusion concept, and established instead a series of deductions to offset excess expenses for housing, education and cost of living.[17]

Many in the expatriate community soon became disenchanted with the Ribicoff proposal, based on its complexity and provision for less relief than legislation introduced by other members.[18] Designed to help the expatriate, the bill seemed limited by the author's perception of what was politically possible. Although the politically possible changed dramatically between 1976 and 1978, the dollar impact of the Ribicoff bill changed little during that time. At the conference between the House and Senate the senator agreed to substantial change.

The Senate Finance committee adopted the Ribicoff bill with little debate as part of H.R. 9251 in February 1978. Hearings on the issue came in May 1978.

The Senate report on H.R. 9251 did not discuss incentives for export promotion. Instead, the committee argued that a flat exclusion was arbitrary and unfair, and cited equitable treatment of individuals working abroad as the reason for change. In the committee's judgment, that seemed to mean that deductions should be tied closely to the increased expenses of working abroad so that American workers would not be at a disadvantage to foreign competitors.[19]

Ways and Means Embraces Equity and Incentives

The Ways and Means subcommittee on miscellaneous revenue measures drafted H.R. 13488 to cover problems in section 911 and section 119. This legislation was similar to that introduced by Congressmen Jones, Crane and Holland,[20] which had the backing of much of the business and expatriate community. Those bills granted both a $20,000 exclusion, and a series of deductions for excess costs abroad, including housing, education, cost of living, home leave and moving expenses.

Section 119 of the Internal Revenue code, which allowed deductions for meals and lodging furnished to an employe on the business premises of the employer and for his benefit, was also amended to create a clear exemption for enforced communal living and other hardship situations. This had been a matter of great taxpayer uncertainty under the earlier general statutory language. The full committee approved H.R. 13488 with some modification and the House passed the bill without change.

According to the new House definition of equity, the U.S. worker abroad should be in a position comparable to Americans working in the U.S. and not at a disadvantage to other foreign workers. The House report also gave credence to the incentive idea, stating that deductions for excess living costs were necessary to encourage U.S. citizens to accept employment in foreign hardship areas. Such U.S. presence abroad encouraged the purchase of U.S. goods and services, and contributed to international goodwill and understanding. To that end, the bill restored the general exclusion to pre-1976 levels, but denied it to Canada and Western Europe; deductions were allowed in all foreign countries for housing, cost of living, education and annual home leave. Meals and housing costs for employees in camps would be excluded, while moving expenses and deferral of gain on selling a home were liberalized.

Time Pressure Impact On Conference

Because of wide policy differences and some procedural difficulties, the conference on the Foreign Earned Income act of 1978 occurred in the final hours of the session under extreme time pressures. At that conference, members were joined by representatives from the Treasury department, including the Secretary. Because Senator William Proxmire (D-Wisc.) and Senator Edward Kennedy (D-Mass.) strongly opposed the House bill and had been willing to block final Senate passage, they were kept informed of the conference decisions. This late in the session, they could effectively block Senate passage, since the Panama canal debate had created a logjam of legislation awaiting passage, and the leadership would not call up any items facing substantial opposition.

Numerous difficult issues had been left to be hammered out in conference. As a result, the conference report contains language that did not appear in either the House or Senate versions of the legislation. This is why it is difficult to find clear policy statements for specific statutory language.

It was generally understood going into the conference that the administration would not accept legislation with a static revenue cost exceeding $400 million (static in that no allowance was made for feedback). Thus, when the Secretary of the Treasury indicated that the fiscal year costs then arrived at could not be exceeded without his recommendation that the President veto the bill, all parties agreed on the draft. The conference report passed the Senate just before daybreak on the morning of October 15, 1978, and passed the House later that same morning.

Reactions - - Current and Future

Reactions have been mixed. Many members of the House and Senate and their staffs had worked very hard to draft legislation correcting the problems brought to their attention. The act ended two years of great uncertainty as to the taxation of Americans abroad. Most taxpayers were happy with the progress that had been made since the 1976 act.

However, many industry people believed that the more liberal House bill was the minimum necessary for effectively competing in the international marketplace, and were unhappy with the compromises reached in conference. Others believed that the engineering and construction industry—which could use the camp exclusion of $20,000 most readily—had in the final conference hours carved out an extra benefit for themselves not generally available to other industries.

No one—expatriates, business, Congress, or the administration—appears happy with the complexity of the Foreign Earned Income act of 1978. As of now, the Treasury department and concerned taxpayers are still identifying the technical questions left unanswered by the legislation, even for 1978.

The 1978 Foreign Earned Income act did not clearly resolve the policy issues in section 911. Specific, but sometimes competing, goals of export promotion, U.S. presence abroad, and equality of tax treatment, whether with foreign workers or U.S. counterparts, were not clearly set forth. Unclear and conflicting legislative guidelines are a great burden on the Treasury department in drafting regulations, and on expatriates and their employers seeking work in the international marketplace.

However, as opposed to the 1976 act, the 1978 act was a constructive approach to the problems in section 911. The telling impact that Americans overseas have on U.S. export policy and other national goals was, probably for the first time, clearly documented and taken into account in the decision-making process.

Only experience during the next two years will show whether the Foreign Earned Income act of 1978 produces an appropriate tax treatment of Americans working overseas. Such experience, again measured against ever changing U.S. goals in the international marketplace, will provide the framework against which any further changes in section 911 will be decided.

OOO

Footnotes - - Foreign Earned Income - - Policy Improved But Not Resolved

[1] H.R. Rep. No. 658, 94th Cong., 1st sess. 200 (1975).

[2] Task Force on Foreign Source Income, Comm. on Ways and Means, 95th Cong., 1st Sess., Recommendations (Comm. print 1977).

[3] S. Rep. No. 938, 94th Cong., 2nd Sess. 210-212 (1976).

[4] See, for example, Earned Income from Sources Outside the United States: Hearings before the House Comm. on Ways and Means, 95th Cong., 2nd Sess. 231 (1978) (Statement of George P. Shultz).

[5] U.S. Department of the Treasury, Taxation of Americans Working Overseas (1978).

[6] Id. at 10.

[7] Former Secretary of Labor and of Treasury, and former Director, Office of Management and Budget.

[8] Taxation of Americans Working Abroad: Hearings before the Senate Comm. on Finance, 95th Cong., 2nd Sess. 37 (1978) (Statement of George P. Shultz).

[9] Earned Income from Sources Outside the United States: Hearings before the House Comm. on Ways and Means, 95th Cong., 2nd Sess. 2 (1978) (Statement of Donald C. Lubick).

[10] Id.

[11] Taxation of Americans Working Abroad: Hearings before the Senate Comm. on Finance, 95th Cong. 2nd Sess. 2 (1978) (Statement of Anthony M. Solomon).

[12] Id. at 4.

[13] Office of Tax Analysis, U.S. Dept. of the Treasury, The American Presence Abroad and U.S. Exports (OTA Paper 33) (1978).

[14] Taxation of Americans Working Abroad: Hearings before the Senate Comm. on Finance, 95th Cong., 2nd Sess. 11 (1978) (Statement of Hon. Elmer Staats).

[15] Id. at 18-22.

[16] But see, Id. at page 23, a study by the Economics division, Congressional Research service, Library of Congress, U.S. Taxation of Citizens Working in Other Countries, an Economic Analysis, (1978).

[17] Congressional Record, S. 2115, 95th Cong., 1st Sess., 123 CONG. REC. S15284 (1977) (Introduced by Sen. Abraham Ribicoff).

[18] Congressional Record, H.R. 11057, 95th Cong., 2nd Sess., 124 CONG. REC. H1390 (1978) (Introduced by Rep. Philip M. Crane).

Congressional Record, H.R. 11065, 95th Cong., 2nd Sess., 124 CONG. REC. H1391 (1978) (introduced by Rep. James R. Jones).

Congressional Record, H.R. 11459, 95th Cong., 2nd Sess., 124 CONG. REC. H1927 (1978) (introduced by Rep. Ken Holland).

Congressional Record, S. 2529, 95th Cong., 2nd Sess., 124 CONG. REC. S1793 (1978) (introduced by Sen. Dewey F. Bartlett).

Congressional Record, S. 2576, 95th Cong., 2nd Sess., 124 CONG. REC. S2168 (1978) (introduced by Sen. James A. McClure).

[19] S. Rep. No. 746, 95th Cong., 2nd Sess. 6, 7 (1978).

[20] H.R. 11065, H.R. 11057, and H.R. 11459, supra. note 18.

OOO

Senator Jepsen, your bill exempts all earned income. What are the provisions for the housing in it? I am not sure how you treat that. But getting back to the exemption of all earned income, as opposed to the measure that I had which exempts $50,000, and then if you start into your third year, you exempt $65,000, and then we treat the housing separately—let's set that aside.

What worries me, and I am open to persuasion on this, are the problems if we go with a complete exemption. First, I worry that we will be attacked for allowing rich movie stars to flee to the Riviera, where they will lounge in diamonds and minks. Second, I wonder whether there is any possibility of abuses that you might foresee. For example, might somebody work out a plan which lets him take very, very substantial salaries abroad while in fact it was not all technically earned income? In other words, could someone camouflage it?

Senator **Jepsen**. I think there may be a limited few that would arrange something so that they could avoid taxes. Some people might say evade them, but I would say avoid them. Therefore, I would be very proud and pleased as this thing unfolds to support and cosponsor a bill such as you have submitted, because it certainly does address those areas.

Senator **Chafee**. Maybe the limitations I've got are too low. I don't know. I don't think anybody is in concrete in that particular part of it.

Senator Bentsen?

Senator **Bentsen**. I have no further questions. I think the testimony by the Senator will be very helpful, though, to us. I am particularly pleased that he relates it to his own State markets, as to how it is affecting them.

Senator **Chafee**. Thank you very much, Senator. We appreciate your testimony, the effort and the energy you have put into it, and your continued support as we proceed ahead. Thank you.

Senator **Jepsen**. Thank you, Mr. Chairman.

[The prepared statement of Senator Jepsen follows:]

Statement of the Honorable Roger W. Jepsen
United States Senator from Iowa
before
The Subcommittee on Taxation and Debt Management Generally
Senate Committee on Finance

June 26, 1980

Mr. Chairman, thank you for the opportunity to testify before your subcommittee today in favor of S. 2321, a bill I have introduced to eliminate U.S. taxes on the foreign earned income of American citizens working abroad. My bill is identical to H.R. 5211, introduced by Congressman Bill Frenzel of Minnesota last year.

My interest in this legislation stems from long conversations with Iowa exporters. Many people who think of Iowa only as a farm state are surprised to discover the the important role which manufacturing plays in the State's economy. In 1977, 240,000 people in Iowa were employed in manufacturing. The total value added by manufacturing for the State amounted to $8.7 billion. These manufacturing firms are very active in export markets. Approximately 20% of all Iowa's manufacturers export. This foreign trade employs thousands of Iowans and is an important factor in the State's prosperity.

Unfortunately, Iowa exporters--including, of course, those involved in agricultural exports as well--have encountered increasing difficulty in marketing their products overseas. One particularly onerous barrier is the tax barrier. Because of high U.S. taxes on Americans who work overseas, in addition to the high cost of living and high foreign taxes, it is very expensive to station U.S. personnel in foreign countries. The Iowa Development Commission, for example, which works to help Iowa companies export their products, is able to maintain only one foreign office--in Frankfurt, West Germany--because the cost of sending additional Iowans to Europe is just prohibitive.

For too many years the United States has been unconcerned about developing foreign markets. The domestic U.S. market was so large that companies could grow quite large without having to sell their goods outside the U.S. itself.

But times have changed. We can't ignore the international marketplace any longer. For one thing, our foreign competitors are too good and they have taken over substantial portions of the U.S. market from American firms. The automobile market is only the most obvious example. In response, many people are asking for tariffs, import quotas and other trade protections for domestic industries. It would be a tragic mistake for the U.S. to follow this route. Ultimately, the U.S. will be a poorer country if measures are taken to restrict international trade.

The real answer is to meet foreign competition by developing our own export markets. As a nation we must become more trade oriented. We must work to remove trade impediments in the U.S. and in the international arena. Passage of the Multilateral Trade Agreement last year was a big step forward, but more can be done.

As I said earlier, one totally unnecessary impediment for U.S. companies engaged in international trade is the excessive U.S. tax burden on Americans working abroad. Existing tax laws make it far more expensive for Americans to work abroad than for citizens of any other industrialized country. The result is that American firms cannot afford to open foreign offices, American firms cannot afford to bid on foreign construction projects, and American firms with foreign business must hire foreign nationals instead of Americans to staff their operations. This creates a negative ripple effect, because when American firms lose foreign construction contracts it affects the suppliers of construction materials and machinery in the U.S., because construction companies are more inclined to use materials and machinery produced in their own countries.

This last point is one I would like to emphasize: Encouraging more Americans to work overseas directly increases U.S. exports. A General Accounting Office survey in 1977 found that 88% of overseas affiliates of U.S. companies estimated that U.S. exports would decline by at least 5% if the very restrictive provisions of the Tax Reform Act of 1976 were implemented. In addition, a 1978 study by the Treasury Department projected a decline of 10% in the number of overseas workers would result in a 5% decline in real exports. Although the 1976 law was later softened by the Foreign Earned Income Act of 1978, it still remains less desirable to work abroad than under the pre-1976 law.

The problem is that many overseas Americans are involved in work which involves substantial procurements or the potential for large amounts of follow-up work. They also tend to be employed in highly-skilled positions, thus involving the export of high value-added services rather than lower value-added commodities and products. Thus, a recent report by Chase Econometrics on the economic impact of changing taxation of U.S. workers overseas noted the following examples of how the increase in taxes on Americans working abroad had ripple effects on the domestic economy:

- A manager of a manufacturing firm indicated that the quantity of machinery and other goods imported from the U.S. dropped 60-70 percent when a local employee replaced the sole American.
- An American sales representative commented that third country nationals "do not have the dedication to sell USA products as qualified American salesmen would, nor are they as dedicated in managing American interests. The 1976 tax bill has been a definite deterrent to American interests overseas. Because of its impact, we are no longer offering overseas to Americans."
- An engineering construction firm operating overseas indicated that a $2-4 million feasibility study could result in a several hundred million dollar contract. Clients tend to favor expanded or duplicate facilities. They generally consider similar design and similar equipment to reduce their maintenance

costs. If the company loses small contracts in the short term, these losses are compounded later on.

- A design and bulding firm reported that 70 percent of needed materials were procured from the U.S. in 1977, but that the figure had declined to 20% as a result of fewer Americans working on overseas projects.

Of course, the major direct impact of high taxes on foreign earned income is on those businesses that are labor intensive and dependent on U.S. workers, principally construction companies. A recent article in the Engineering News-Record points out that of 22o construction contracts awarded in 14 Middle East countries during the 13 months ending June, 1979, shows U.S. firms with only seven new jobs worth $346 million. That's 1.6% of the total $21.8 billion worth of new construction counted in that period. An earlier analysis of 542 major construction projects started in the same Mideast countries between June, 1975, and April, 1978, showed U.S. companies had signed up 10.3%, or $8.9 billion, of the $86.3 billion total volume during that period.

Unfortunately, this situation is likely to get worse unless we act. According to the Treasury Department's own analysis the largest average increase in taxes on Americans working overseas is in Middle Eastern and African OPEC countries. These countries can be classified as developing countries which are growing export markets for the U.S. Losing our "foot-in-the-door" in these countries will have a profound effect on future exports.

Consequently, Chase Econometrics has calculated that the loss of U.S. exports from increased taxes on foreign earned income vastly exceeds the increase in revenue to the Treasury from the tax law change. Chase points out that a 5% drop in U.S. exports translates into a loss of personal and corporate tax receipts of $6.1 billion, whereas the gain in revenue to the Treasury from the tax change was a mere $189 million net.

Lastly, I would like to draw the committee's attention to the findings of a recent trip by members of the Joint Economic Committee to the Far East. The East Asia Study Mission reported as follows:

"Taxation of Americans living overseas was uniformly cited by American business representatives in East Asia as one of the most critical problems facing U.S. exporters in that region. Significantly, the attention given this issue at every stage of the Mission's visit was not based on personal hardship because most companies compensate their American employees for the added tax burden. Instead, American businessmen emphasized that because many companies do compensate their employees, their cost of employing an American national, compared to other third country nationals, is significantly higher. American tax laws, therefore, encourage these companies overseas to reduce the proportion of their expatriate staff who are Americans. The example of a firm operating in Singapore was cited. Of approximately 100 expatriates, 19 percent were third country nationals in

1975; by 1979 this proportion had increased to 41 percent. Where companies do not compensate, the effect is just the same. Because of the tax burden, Americans can simply not work or serve as business representatives at the same level of compensation as Britons, Australians, or other third country nationals.

"The reduction of Americans working overseas has an adverse effect on U.S. exports because Americans involved in purchasing, equipping, or design decisions are familiar with U.S. goods and technology and tend to specify and order American equipment and services. Europeans and other third country nationals are naturally more familar with and tend to buy the products of their own countries.

"The heavy burden of American taxation, it was suggested, most adversely falls on independent businessmen, professionals, and employees of charitable organizations and international organizations, many of whom have been forced to repatriate. As one witness stated: 'You are looking at a dying breed. When your Committee comes back to Asia, you probably will not find us here.'"

I am sure that many of the other witnesses before your committee today will go into much greater detail on these points. I urge the Finance Committee to remember that what is involved here is a trade issue and a jobs issue, and only secondarily a tax issue. I urge passage of the Jepsen-Frenzel legislation to simply eliminate U.S. taxes on the foreign earned income of U.S. citizens working overseas.

Senator CHAFEE. Congressman Bill Frenzel was down on the list, but I do not believe he is here. How about Congressman Steve Sims? He might be on the way over, and if so, we will take him up at the opening that comes following his appearance.

Mr. Lubick, Assistant Secretary of the Treasury, is here, and we welcome you, Mr. Lubick.

STATEMENT OF HON. DONALD C. LUBICK, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. LUBICK. Thank you, Mr. Chairman and Senator Bentsen.

If you please, I have a prepared statement for insertion in the record, and I will make some brief extemporaneous comments on the subject.

The bills before you, as you have indicated, would exempt earned income of U.S. citizens employed abroad in varying amounts. You have already outlined them, so I won't repeat that. Our estimate of the revenue reductions involved from the various bills run upwards from $425 million to $500 million at current levels of income.

Senator CHAFEE. That is with complete exemption?

Mr. LUBICK. No, that is basically your bill, Senator Chafee, but they are all very close to complete exemption. Because the amounts involved once you get over the $65,000 mark do not aggregate a large amount of revenue, so it is tantamount to—pretty close to complete exemption.

This issue, as you are aware, was intensively discussed following the 1976 act for a couple of years, which led to the enactment of 1978, and it is just this past June 15, less than 2 weeks ago, that the due date arrived of the first returns that were wholly under the 1978 law. So, for the first time, when we are able to process these returns we will have data as to the impact of the 1978 changes. You will recall that the 1978 act targeted its relief to high living cost and hardship situations.

Both the 1978 law and most of the proponents of change, and as I deduce from questions which you asked Senator Jepsen, you yourself, accept the basic policy, as a matter of tax equity, of taxing U.S. citizens on the basis of citizenship rather than residence. As you indicated, no one seems very much to want to exempt dividend income received by the Americans you referred to on the Riviera, or indeed the earned income of movie stars who are perhaps at the Riviera, Gstadt, or some of those other notable European places.

I think this position is an acceptance of the fact that U.S. citizenship does convey significant benefits to the holders thereof—and they are not in any way anxious to give that up, even for the siren benefits of complete tax exemption—and I believe it is a recognition that it is appropriate that all of our citizens share in the cost of our government. Certainly as to the Federal Government, as opposed to the State governments, the benefits of citizenship are conferred upon American citizens living outside the United States as well as those in the United States.

Now, there is another side to tax policy, as I am very familiar, having been before the Finance Committee for 3 years, besides equity. And that deals with some of the very significant economic problems that we face. I think we are all in agreement that U.S.

citizens and businesses must be able to compete in world markets, and that the promotion of exports is important.

So, there does seem to be a rather large measure of agreement, between us and among all of those agencies of the Government that are involved, in the fundamental principles that we are striving for. If we are deviating from tax equity, it is important that we do so for compelling reasons, and based upon some plausible evidence that we will accomplish the result which we seek to accomplish, and that we do it in a cost effective way.

Therefore, we are looking forward to reviewing the data which we expect to receive from these first returns under the 1978 act, and we are working closely with our counterparts in the Department of Commerce and the Office of the Special Trade Representative and other departments of the Government to try to get an accurate picture of the situation of Americans living abroad.

There has been considerable anecdotal evidence of the impact of taxation on U.S. exports. Some of it appears to be normal exaggeration, but much of it does make some compelling points with respect in particular to the situations you have referred to of our situation in the construction and engineering operations of U.S. businesses in the Middle East.

The fact of the matter, however, is that overall, the number of Americans living overseas seems to be increasing, and our rate of exports has been increasing at the rate of 25 percent a year.

Senator **Chafee**. Mr. Lubick, first of all, the number of Americans abroad, we are not counting retirees. You have some statistics on those earning their living, and when you say exports have increased 25 percent, are you talking, obviously, in dollars?

Mr. **Lubick**. I am talking in nominal dollars. That is correct.

Senator **Chafee**. Is the figure you gave of the increased number of Americans, those of people earning their living?

Mr. **Lubick**. Yes, Mr. Chairman, that is our figure with respect to those who are eligible for the provisions of 911 and 913. So it is in that area of earned income.

In addition, if one looks at our total exports, much of our total export business is to Canada and Western Europe. Canada alone accounts for a fifth of our exports, Western Europe a third, so over half of our exports are to countries where rates of taxation for persons working in those countries are in a reasonably comparable range to that of U.S. taxation, so that the additional taxation through the residual taxation by the United States is normally an inconsequential burden.

Many of the employees who are deriving earned income abroad, especially in Europe, work at jobs that have nothing to do with exports, and many of them even work at jobs that are encouraging imports into the United States. As to those employees, relief targeted to them through taxation will not have an export impact.

The extreme cases, as you have indicated, are in the construction industry, in particular in the Middle East, and there we have some disturbing figures of loss of contracts. As has been indicated in the trade journal articles—which we have referred to in our statement on page 3—there are a lot of factors that contribute. Taxation certainly may be one, but we ought to recognize that there are a number of other factors as well. The competitiveness of South

Korean construction companies was cited, our antibribery laws, political upheavals, and so on.

The argument has been made that U.S. employees influence purchases, and again, we would like to study the evidence as to this. Certainly the number of employees who are in a position to influence purchases is a restricted number, and the cost of their salaries is a relatively small portion of the entire cost of the contracts.

Again, there is a premise that they will buy American only when American goods can be purchased at a cost that is comparable to the cost of purchasing from foreign competitors. Indeed, you referred to Americans purchasing foreign automobiles in larger and larger numbers; that is one indication that there are some factors involved here beyond who the purchasing agent is.

There is a recent report done by Chase Econometrics that has been widely publicized and that has been referred to today, which talks about a 5-percent decrease in our exports. We have appended an analysis of that study to our statement. Again, I would like to urge us all to eschew a lot of the rhetoric and try to resolve this as much as possible on the basis of facts and logic. If one looks at the Chase report, the figure of a 5-percent decrease in exports, which was the same figure used in the Export Council report, is based upon a GAO survey of what businessmen said they expected to be the consequence if the 1976 act became law. Most of them said they expected a 5-percent reduction in exports. This premise, then, of a reduction in exports is not based on what the effect was of the 1978 changes, but rather what the anticipated effect by these businessmen was of provisions which never came into effect.

We propose to review this problem, and I want to state that we are going to look at it with an open mind. We are going to look at the data to see if indeed changes in the tax law, as well as other changes in the whole area of exports, are going to have and can have a significant impact upon our export promotion. We tend to agree with you, Senator Chafee, that an American presence abroad is a desirable thing.

We have indicated on pages 5 and 6 of our statement some alternative approaches which we think should be looked at and studied. For example, we have noted that a number of our competitive trading partners have been using a targeted approach. They have been providing special exemptions, for example, in certain areas of endeavor, the construction field notably being one of them.

It seems to us that if we are going to move ahead to promote exports at a time when, it is very important that we revitalize our entire industrial economy—and I know this is something that is of great consequence and that the problem is recognized and strongly appreciated by Senator Bentsen—the dollars that are spent for that purpose are precious dollars and must be expended wisely.

Therefore, if we are going to have a substantial revenue expenditure for this purpose of export encouragement, it ought to be focused on accomplishing that result, so that we have all of the dollars that are needed for the general reindustrialization and revitalization of our industrial plant and equipment.

Now, I am going to try to anticipate the next question you were going to ask me, Senator Chafee, because I read your statement in the Congressional Record accompanying the bill which you introduced, and therefore I assume you are going to talk about what foreign countries do with respect to their nationals who are employed, let's say, in the Middle East on construction contracts.

Again, we have here a situation where it isn't all that clearcut that we alone tax on a citizenship basis and everybody else does not tax nonresidents. The legislation which you are talking about would provide exemption in many cases for employees who are still domiciled in the United States, who may simply be abroad for a limited period of time, and most of the other countries who are our competitors do not provide a complete exemption except with respect to those who are domiciled abroad.

A number of them, as I have indicated, are struggling with this very same problem of exempting special situations, construction contracts for developing countries and the like. So, I think those are approaches which are worthy of consideration and we ought to study them.

We also ought to take into account the fact that the bulk of the overseas Americans, approximately two-thirds of them, are located in places like Canada and Mexico and Western Europe, Japan, Australia, Rio, Bermuda, and so on, and it is very questionable that a special incentive is needed for those persons.

Lawyers practicing in Paris are most apt to choose that in comparison to Providence or even Houston for reasons that may have nothing to do with taxation, and those persons indeed do derive substantial benefits from their citizenship. The obligations that they shoulder perhaps living on the Champs Elysee ought to be as much as those who live on Reservoir Road in Washington.

If the problem basically is this narrower group that is living in places like Riyadh or Yemen or what have you, that clearly impose a hardship compared to living in the United States, then indeed I think we ought to be looking at ways to expedite American presence in those industries and those countries. We intend to go at this in an expeditious and a logical way, as I stated, without preconception.

We hope, as soon as we are able to digest this body of returns that has just come in, that we will be able to present to you some significant evidence and recommendations in this area.

Senator **Chafee**. Mr. Lubick, I hope, if you are not able to stay here, that somebody from your office can hear this anecdotal evidence. When you get, as both Senator Bentsen and myself have, on our respective trips, this torrent of evidence, with people who show grief over what is taking place, it seems to me it can't just lightly be dismissed.

It is like the question which they asked the fellow: "Do you believe in infant baptism?" "Believe in it," he said, "I've seen it." [General laughter.]

We are in the same situation here. The thing that bothers me about your approach and that of the Commerce Department, and indeed the administration, is that we have got a problem, and the problem isn't solely here. It is also with the Foreign Corrupt Practices Act and a whole series of other disincentives. Yet, the administration, which you represent, always says that we must have absolutely hard evidence before we can take a step. The burden of proof always must rest on those who want to make some progress in solving a problem.

It isn't just the preponderance of evidence. It must be beyond a reasonable doubt in order to move forward. The amount of revenue, even by your own estimates, which seldom underestimate the loss of revenue is $460 million. This is your estimate with the smaller of the bills. Now, we don't want to dismiss $460 million as nothing, but with the figures with which we deal in this room, as you well know, that has no significant effect on the revenues of the United States with the possibilities that it can yield some of the returns that have been shown.

Mr. **Lubick**. Let me assure you that we are not trying to achieve the degree of scientific certainty that would be required by the FDA to permit a drug to be labeled safe and effective. It is perfectly obvious that much of this cannot be demonstrated scientifically. You can't extricate one cause from all of the many factors that are causing this problem.

We do expect, however, to be able to focus upon those areas where the allowance of tax relief stands a reasonably good probability of producing these results, as opposed to those situations where the chances of tax relief altering the cost and achieving benefits that you are alluding to are reasonably ephemeral or illusory or will-o'-the-wisp. I certainly believe that we can sort the situation out to the reasonable satisfaction of reasonable people, and I would hope that if we have not always been that way in your light, we would be moving in that direction.

We certainly are not asking for absolute irrefutable beyond a reasonable doubt evidence. I don't think that is the situation at all.

On the other hand, I think one should not on the basis simply of the assertion that we have a problem, in one area, which everyone agrees, say therefore that our citizens, no matter how situated, where situated, or what they are doing, are completely relieved from their share of the obligation to meet the tax load. That is detrimental, as you know, to the perception of the fairness of the tax laws. People will respond to granting tax relief if they see an opportunity to get a benefit for it, but generally speaking, exemption—and you yourself used the illustration of the Americans on the Riviera—just doesn't sit well, and does have a very serious impact in terms of equity, let alone revenue.

We think we can come up with a solution that will be in the best nterests of promoting exports of the United States and will be consistent, generally speaking, with equitable principles of taxation.

Senator **Chafee**. I would just like to briefly point out that the key factor, I think, is the U.S. share of world exports. Sure, exports are growing. If they didn't grow, we would be going backward because of the inflation, but the U.S. share of world exports has dropped from 25 percent in 1955 to 15 percent in 1979.

Now, 25 to 15 is a 40-percent drop, and we have had the figures lready on the Middle East construction. On manufactured goods, s you know, we are now running a balance of payments deficit, a alance of trade deficit in our manufactured goods. So, it isn't the il that is upsetting all the equations. It is happening in manufactured goods.

Just one last question. Are you satisfied that the 1978 law is so complicated that an individual citizen abroad is unable to complete his tax return and that professional advice, very, very skilled professional advice, is limited to a few people in order for one to complete his return?

Mr. LUBICK. Well, I have heard that——

Senator CHAFEE. That is, using the 911 and 913.

Mr. LUBICK. I have also heard that in the United States. Indeed in the last 2 years I have found it to be so; not that I couldn't prepare my own tax return, but I have finally given up myself and engaged someone to do it. And I have not used either 911 or 913.

The one part of the act that seems to present the most complications is the housing allowance, and I note, incidentally, that is the part you propose to retain. I think that has been, from what we have heard, the one part that has presented the most complications. We will be able to judge that fairly well, too, when we see the returns and analyze them and see what the percentage of errors is, and just how serious a problem it has been.

As far as we know, by and large, the more difficult situations are normally handled by accounting firms, and our accounting firms do have a presence around the world.

Senator CHAFEE. We are going to have some accountants testify, and if you could have somebody stay, we would appreciate it.

Mr. LUBICK. Certainly, Mrs. Field will stay from the Treasury.

Senator CHAFEE. Fine. Thank you.

Senator Bentsen?

Senator BENTSEN. I might say that my friend, the very distinguished Assistant Secretary, is as usual an articulate proponent of his point of view.

Mr. LUBICK. I haven't been trying to propose a point of view, Senator Bentsen. I have been trying to propose an objective, open mind, not an advocacy.

Senator BENTSEN. Well——

[General laughter.]

Senator BENTSEN. From that objective point of view, I hope that the Secretary will forgive me if I remain not quite persuaded.

During my trip to East Asia with the JEC in January we heard testimony from members of major accounting firms overseas who had been preparing the tax returns of American businessmen overseas. We thought we had taken care of the problem of 911 and 913, but it became very obvious during those hearings that we had not; that very gross inequities still exist.

There were cases in some countries where recent changes in our tax law seemed to do the job, but that seemed to be a minority. In other cases our people were in a discriminatory position as compared to nationals of other countries particularly in regard to housing. That is my concern. In the legislation I have proposed, I pegged overseas housing deductions to a percentage of the GS-14 salary. It became an arbitrary amount, and it ought to be relatively easy, I think, to administer it.

When we consider trade increases in the Far East, where trade is increasing at a rate of 22 percent compounded a year for the last 5 years, and our percentage of that trade is diminishing, and as I looked at a trade deficit that may approach $40 billion this year, and the trade deficit of the last 4 years which, as I understand it, exceeds the total trade deficit of this Nation for the last 200 years, then I know that this kind of hemorrhaging of funds, which is obviously complicated by the importation of oil, $90 billion of it at least this year, then I know that we really have to do everything we can to try to encourage exports.

In the process of doing this that we may err perhaps on the liberal side for some people, but I think I would rather risk that, if what we have done is to encourage American nationals to live abroad and engage in exports, and try to increase those exports.

So, I approach it from that point of view. I would say, Senator Chafee, if you will forgive me, since I had 9 days of hearings on this subject, and if there is something new told you today, would you let me know later? I am going to take care of some of my other responsibilities.

Senator **Chafee**. Well, thank you very much for coming, Senator Bentsen. I know you were deeply involved in this on your trip to the Far East: so, we will keep you posted on how things come.

Mr. Lubick, it seems to me that what you are saying is that the Treasury is looking at a targeted approach, and that your thinking presently is geared toward somehow going to those areas of the world that might be considered hardship cases or else possibly pinpointing those employees whose work is related to exports. Is that what I am gathering from your remarks?

Mr. **Lubick**. Well, I think certainly those are ideas that ought to be examined. I don't know yet if they are entirely feasible, and I don't want to exclude the approach that you have taken or something else, but I certainly think there is significant promise to those. A number of other countries of the world of the OECD nations indeed have taken or are moving in that direction.

Senator **Chafee**. Well, I would like to say that any time you get involved in that the complexities are extreme. Furthermore, I would like to point out that you mentioned that I had a housing provision, which could possibly involve complexities of the 913. My housing provision is this. You are taxed on 20 percent, up to 20 percent, of your salary on that amount that is given you for housing, and beyond that it is free. I think that is really far simpler than 913 treatment of housing as I understand it.

The other point is that this originally passed, as you recall; I wasn't here then, or on the committee then. But the argument of equity prevailed over the argument of trade, and yet we don't end up in this country that everybody pays exactly the same amount of taxes. If somebody has a complete portfolio of tax free bonds, he pays very minimal tax, nowhere near the tax. We do that for a justifiable public purpose.

So, I wouldn't say that we are embarking into new territory in attempting to do something for a public purpose, namely, the overall welfare of the country, by increasing our exports and improving jobs in the home market.

Mr. **Lubick**. I certainly agree with you, Senator Chafee. The normal rule is indeed equity, but even in the 1978 act there were a number of situations where we went beyond that for a deliberate incentive. There are hardship allowances without references to income, for example. But I think what I suggested was that where there is an overriding national interest then the accomplishment of that might be such that it is appropriate to have some deviation from equity; but I simply raise the question as to whether many, and perhaps the bulk of the situations that overriding national interest is in fact present.

If, indeed, we can zero in on those areas where we do have a difficult problem, and we can do it without intolerable complexity, it may be a desirable way to deal with the national interest.

Senator **Chafee**. Well, we thank you for coming, Mr. Lubick.

Mr. **Lubick**. Ms. Field will remain here.

Senator **Chafee**. Ms. Field will be here. We would appreciate that.

Mr. **Lubick**. She knows more about this subject than anybody in the Treasury.

Senator **Chafee**. I am biting my tongue. [General laughter.]

[The prepared statement of Mr. Lubick follows:]

FOR RELEASE UPON DELIVERY
2:00 p.m. (E.D.T.)
June 26, 1980

TESTIMONY OF THE HONORABLE DONALD C. LUBICK
ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY
BEFORE THE SUBCOMMITTEE ON TAXATION
AND DEBT MANAGEMENT OF THE
SENATE COMMITTEE ON FINANCE
S. 2283, S. 2321, S. 2418

June 26, 1980

Mr. Chairman and members of the Committee:

I am pleased to be here to discuss with you several proposals to modify the taxation of income from foreign employment. The bills under consideration today would exempt most or all income earned abroad by U.S. citizens. S. 2321 would replace the deductions, hardship exclusion and "camp" exclusion of present law with an exemption of foreign earned income, without any dollar limitation on the amount excludable. The other bills, S. 2283 and S. 2418, would retain a deduction for housing expenses abroad in excess of the presumed cost of housing in the United States plus an exemption of foreign earned income up to a maximum amount which ranges from $50,000 to $65,000. The computation of the housing deduction differs, but the general thrust of the proposals is to exempt most or all foreign earned income from U.S. tax. Our tentative estimate of the cost of complete exemption of foreign earned income, as provided in S.2321, is almost $500 million in 1981. The tentative estimate of the cost of the other bills is somewhat lower, roughly $425 - $460 million.

As you know, the issue of how we should tax Americans who work abroad was discussed extensively and intensively for more than two years prior to the enactment of the Foreign Earned Income Act of 1978. The Administration's proposal at that time went along the same lines as the 1978 Act of targeting the tax relief to situations where high living costs and/or hardship conditions seemed to justify treating Americans working in those situations differently from Americans working at home.

The 1978 law did not contemplate giving up our basic policy of citizenship basis taxation. Nor do the bills before this Committee. We think it is widely accepted that U.S. citizenship conveys significant benefits to those who are currently working abroad, and that the appropriate measure of each taxpayer's contribution to paying for those benefits is the amount of his income, the number of his dependents, and his expenses for purposes for which the law provides deductions. The 1978 law expanded the expenses for which deductions are allowed in the case of Americans who work outside the United States.

Targeting the tax relief in this way is a new approach for us. The 1978 provisions only fully took effect for 1979 income, for which returns were generally due on June 15, 1980. The Treasury Department is required by statute to study those returns and to assess the revenue and economic effects of the new law. We intend to study all available evidence on how the 1978 provisions are operating and we welcome the information this Committee assembles on this issue. But even apart from budget constraints, we consider a change at this time to be premature.

Impact on Exports

The criticisms we hear most are that the various special deductions and exclusions authorized under section 913 are complex and do not permit full recovery of the added cost of earning income outside the United States; and that such taxation places our citizens and corporations at a competitive disadvantage in world markets and limits our export of goods and services.

These are obviously serious claims. The Administration and the Congress are both deeply committed to reviewing actions the Federal government can and should take to promote exports. We will be submitting to the Congress next month a report on export incentives and disincentives under Section 1110(a) of the Trade Agreements Act of 1979. We have just completed compiling public comments on the subject and are in the process of analyzing them. Our review in formulating the Administration's export promotion program will balance a range of considerations including trade effects, foreign policy, and tax consideration. Because the bills before you today would partially or totally exempt foreign earned income from U.S. taxation, we believe that it is important to review carefully the evidence that our exports will, indeed, be assisted.

Many of the statements about the impact of U.S. taxation on exports of goods and services strike us as exaggerated. Nearly one American in seven living outside the United States is just across the border in Canada. Because Canadian taxes are comparable to those in the United States, changes in our tax laws don't have any significant impact on U.S. citizens resident there. Canada accounts for almost a fifth of our total merchandise exports, and it is unlikely that those exports are impacted by citizenship basis taxation.

Much the same can be said of Western Europe, which presently absorbs almost a third of our exports and a third of our nonresident citizens. With the various cost-of-living deductions available under the 1978 Act and European tax rates generally higher or comparable to those in the United States, the additional U.S. tax (if any) is typically a small percentage of a U.S. citizen's total compensation. Moreover many Americans in Europe work at jobs bearing no relationship to U.S. exports. Thus, it is also unlikely that U.S. taxation of our overseas citizens is having a perceptible impact on our exports to Europe.

What we hear most about are the extreme cases, like the construction industry in Saudi Arabia. A series of three articles in the Engineering News Record in November and December 1979, investigated this sector of overseas operations. They reported that U.S. construction companies' share of new contracts in the Mideast had dropped from 10.3 percent to 1.7 percent since 1975. Although the Engineering News Record cites our taxation of U.S. construction personnel as one causative factor, it also cites many other factors: the increasing competitiveness of South Korean construction companies, our anti-bribery and anti-boycott laws, the political upheaval in Iran, and the lack of aggressiveness of U.S. companies in going after overseas business.

It is extremely hard to isolate the effect of our taxation of overseas citizens from other economic factors affecting exports. However, even in the extreme case of the construction industry, U.S. taxes appear to be adding, on average, no more than two percent to total costs. In other industries, the percentage has to be much less.

Moreover, it is worth remembering that a small percentage of Americans working overseas are in the extreme case. Our latest information shows only 3 percent of Americans employed overseas in Saudi Arabia and only 10 percent in all of the oil producing countries of the Middle East and North Africa.

The Engineering News Record article also noted at some length the paucity of hard evidence that U.S. citizens or corporations bought more in the United States than foreign companies did. It cited an Aramco study which suggested that Aramco's U.S. contractors did rely more on U.S. suppliers of materials and equipment than its foreign contractors did, but noted that the U.S. suppliers might be sourcing from their foreign, and not their U.S., plants. The article also cited an internal Fluor study which ranked U.S. suppliers fifth behind their Japanese and German competitors in terms of quality control and reliability, "getting what you paid for."

To the best of our knowledge, the most sophisticated analysis of this issue was done by a Treasury employee, John Mutti, who spent a year at the Office of Tax Policy in 1977-78. Dr. Mutti analyzed 1974 and 1975 statistics. He acknowledged the obvious limitations of the data and of his methods and cautioned against placing too much faith in his results. He found that the number of Americans resident in a country showed a statistically significant relationship to the value of U.S. exports, but that "any tax increase is estimated to have a small effect on the number of Americans working abroad." He concluded that, even if we were to have eliminated the 1975 law and subjected Americans employed abroad to full taxation with no special relief, his equations would show a drop of 2.7 percent in manufactured exports. It is important to remember that he was referring to complete repeal of prior law. Prior law was not repealed; nor is anyone proposing repeal of Section 911 and 913. On the other hand, the 1975 law itself is no longer relevant. Once we have more information on the 1978 law and use correspondingly recent export data, Professor Mutti's methodology may be useful in establishing more precisely the export impact. But as he cautioned, "These findings are based on a preliminary attempt to analyze more thoroughly the ways Americans abroad may influence U.S. exports. Efforts to improve the data used and the procedures applied are needed to confirm or negate the reported results. Since the results presented in this paper are preliminary, it is important to recognize the proper context in which to apply them and to do so with caution."

Recently, Chase Econometric Associates released a report, "Economic Impact of Changing Taxation of U.S. Workers Overseas," prepared for a construction industry group, the U.S. and Overseas Tax Fairness Committee. The Chase study concluded that recent changes in U.S. tax policy increased domestic unemployment by 80,000 jobs and reduced Federal income tax collections by $6 billion. This, we take it, is supply-side economics with a vengeance! The Chase report bases its estimate on an *assumption* that recent U.S. tax changes will decrease 1980 U.S. exports by 5 percent of what their value would otherwise have been. Why 5 percent? Chase cites a 1978 GAO survey of U.S. corporations, most of whom predicted that U.S. exports would drop by at least 5 percent if the 1976 version of section 911 became law, which it did not. The GAO cautioned against taking its survey of companies adversely affected by the 1976 law at face value, and we assume that caution still stands. The GAO study did not address what impact the substantially more liberal 1978 law might have, so it provides no support for Chase's assumption. The Chase study also cited the Treasury study undertaken by Dr. Mutti, but here too they have misapplied the findings. Dr. Mutti stated one of his findings as follows: if the number of U.S. citizens resident abroad were reduced by 10 percent, U.S. exports would fall by 5 percent. He did not say that that *was* the probable impact of any recent change in our tax law -- indeed, he found that U.S. tax rules had a small impact on the number of U.S. citizens resident overseas and that even complete repeal of the 1975 law would not have reduced exports by 5 percent. In short, the Chase assumption that recent changes in U.S. taxation have caused U.S. exports to fall by 5 percent and, by implication, to cause the loss of 80,000 jobs and $6 billion in tax collections, is totally groundless.

Alternative Measures

If we intend to retain an income tax which applies to all citizens, we cannot ignore the principle of fair treatment of all taxpayers. We recognize that other countries place emphasis on residence or domicile, but our policy has always been to share the costs of U.S. Government among all citizens. If our tax policy is impeding our exports, we are concerned about that. But if that problem arises, it is not a general one, affecting all Americans who work abroad, but a selective one, affecting those who meet certain conditions. In that event, targeting additional relief to export related activities would do less violence to our traditional standard of fairness. It would also cost less revenue.

Some other countries, for example France and Germany, use a targeted approach. Although they generally retain income tax jurisdiction over individuals who work abroad but keep a home in the country (or otherwise indicate that they expect to resume residence there), they provide a special exemption for such individuals if they are employed abroad by local companies in selected activities. The favored activities are, in general, construction and installation projects and natural resource exploration and extraction. We recognize that this approach, like any which requires drawing lines, involves difficulties. It is hard to draw a clear line without inadvertently putting some people on the wrong side of it. Nevertheless, if we decide to depart from our basic principle for a specific purpose, we ought to limit that departure as much as practical to the achievement of the desired purpose. As this Committee will understand, not all Americans who work abroad influence U.S. exports. Some produce goods or services for the local market or even for import into the United States.

Special relief could be directed to the employer, perhaps as a form of targeted jobs credit. This approach would reduce the number of eligible recipients and thus be easier to administer. And it could be drafted to permit administrative flexibility by specifying the general criteria in the statute but allowing the Secretaries of Treasury and/or Commerce to designate qualifying employers.

Canada has recently proposed a legislative change which would follow the example of France and Germany in providing relief to individuals employed abroad in specifying activities. In addition to specified activities, the Canadian approach would direct the relief to specified countries, as designated by the Government. The Canadian proposal is not a full exemption but an exemption of one half of the foreign earnings from the designated activities and countries up to a maximum exemption of $50,000 per year.

Still another possibility would be to modify the deductions allowed under present law, for example by varying the cost of living deduction with the recipient's earnings rather than pegging it to the salary level of a GS-14 civil servant. This would not be a simplifying change; but we note that some of the bills before the Committee would retain a housing deduction, which is the most complicated of the deductions allowed under the 1978 law. And a bill recently introduced by Senator Mathias would retain all of the expense deductions of the 1978 law.

We are not proposing any of these changes as an Administration position. We want to reserve judgment on what changes, if any, should be made until we have more evidence on the scope and extent of the problems encountered under the 1978 law. If further change then seems appropriate, our preference would be to tie further relief as closely as practicable to solving those problems.

o O o

Treasury Comments on the Chase Econometrics Study

I. Impact on the economy

The heart of the Chase report is found in Chapter V, part 2, which reports the impact on the economy of a drop in exports. The key statement, made at the top of page 33, is: "The evidence from our surveys and from prior studies indicates that the reduction in exports is on the order of 5 percent."

1. What causes the drop in exports are "recent revisions" in the tax law (page 1). The report does not clearly identify what revisions; it refers variously to 1975 practice, 1975 law, 1976 amendments (which never took effect) and the 1978 amendments. Apparently, the relevant revisions were the 1978 law compared with the 1975 practice of excluding $20,000 or $25,000 plus, in some cases, part or all of housing and other expenses paid by the employer. This is erroneously described as 1975 law; if the 1978 changes were repealed in a return to 1975 law, it would not permit a return to this practice. Nevertheless, taking this change at face value would have meant an estimated increase in tax on 1977 incomes of $209 million in 1977. Since the study alleges that the Treasury estimates are 2.6 times the correct figure (pp. 31, 32) presumably they reduce this to $79 million, and then adjust that figure to a 1980 estimate. That additional tax cost reportedly generates a drop of $16 billion in exports.

2. According to the report, the drop in exports is 5 percent according to "our surveys" and "other studies." "Our surveys" comprise responses from 13 construction/engineering firms and 24 members of American Chambers of Commerce overseas. The responses by both groups are tabulated in Appendix A. There is no reference to exports in the tabulation of the construction firm replies. The C of C replies show 17 companies with exports of $77 million in 1976, 17 companies with exports of $95 million in 1977, 18 companies with exports of $113 million in 1978, and 21 companies with exports of $164 million in 1979.

The "other studies" are a 1978 GAO questionnaire and a 1978 Treasury study. The first asked businessmen what they thought the impact on exports would be if the 1976 Tax Reform Act amendments were enacted, and most felt that exports would decline at least 5 percent. The 1976 Tax Reform Act was not enacted; it would have raised taxes much above the level of the 1978 Foreign Earned Income Act. The second study found that there appears to be a response of exports to American presence on the order of 0.5; so that a 10 percent decline in Americans overseas would be expected to produce a 5 percent drop in exports. It did not say that there had been or would be a 10 percent decline in Americans overseas due to the 1978 Act tax policy. It estimated that if there were full taxation of all foreign earned income with no special deductions or exclusions, manufactured exports would be expected to drop by 2.7 percent. The current estimate of that impact is 2 percent.

3. In applying the 5 percent figure, Chase states that exports in 1980 will be reduced by $6.6 billion in 1972 prices and by $16.2 billion in current prices. Net exports of goods and services in current prices in 1979, according to the national income accounts were $258 million. $16.2 billion is 5 percent of $324 billion, which would be the 1980 figure for net exports of goods and services assuming a 25 percent growth rate. Perhaps this is where they derived the 5 percent number. However, net exports of goods and services includes a number of items unaffected by the presence of American employees abroad -- military sales, tourism, dividends, interest, royalties and other income from unrelated foreign companies, government services, repatriated foreign earnings of U.S. oil companies and affiliates. Nonmilitary merchandise exports in 1979 -- including grain sales which are probably little affected by overseas employees -- were $182 billion (of which $16.2 billion amounts to 9%). In any event, a 5 percent drop in exports of all goods and services implies a significantly higher reduction in exports directly related to U.S. employees overseas.

4. A $16.2 billion drop in exports (assuming they use current price data) is said to generate a decline in the same year of $6.5 billion in federal tax revenues; i.e., the U.S. government share is 40 percent of any change in exports. This implies an unusually rapid response to a change in exports.

II. Revenue estimates

The Chase study criticizes the Treasury's tax expenditure estimates as too high because they do not take into account corporate tax deductions for tax reimbursements. However, the Chase adjustment is seriously overstated. They take the Treasury tax expenditure estimate of the cost of 1975 law in calendar year 1977 of $498 million and reduce it to $189 million (page 31). To do this, they made five assumptions, that:

1) Without the exemption allowed under 1975 law, 30 percent of Americans working overseas would come home. This is no more than a guess. The Mutti study, which they try to use elsewhere, suggests that the impact would be small;

2) All of the Americans who would continue to work abroad are in the 50 percent bracket. This is not accurate. Many, including a large number of employees of charities and schools, are in a lower bracket;

3) All Americans working abroad are employed by U.S. corporations subject to U.S. tax; i.e., no Americans are employed abroad by foreign companies, foreign subsidiaries of U.S. companies, U.S. charities not subject to corporate tax, or are self employed;

4) In all cases the employer pays the U.S. tax on the added compensation and allowances for overseas employment; and

5) None of the employees has excess foreign tax credits which can be used to offset the U.S. tax.

U.S. Treasury
Office of Tax Policy
June 23, 1980

Senator **Chafee**. We are delighted to have Mr. Frenzel here, Representative Frenzel from Minnesota, who has given a good deal of thought to this matter and has introduced his legislation in the House of Representatives.

Mr. **Frenzel**. Mr. Chairman, I am joined here by one of the coauthors of my bill, Mr. Royer of California, and Mr. Symms is also interested in this. Maybe we could do our thing jointly.

Senator **Chafee**. Fine. Is Mr. Symms here? Yes, right here. And Mr. Royer. Fine.

Well, gentlemen, we are delighted you are here. We appreciate your coming over. I heard a little squeak. That wasn't a rollcall over in the House?

Mr. **Frenzel**. As far as we know, not.

Senator **Chafee**. All right, fine. Why don't you proceed, Mr. Frenzel?

STATEMENT OF HON. BILL FRENZEL, A U.S. REPRESENTATIVE FROM THE STATE OF MINNESOTA

Mr. **Frenzel**. Mr. Chairman, I would ask unanimous consent that any of us here that have statements, that those statements be admitted into the record, so that we might proceed.

Senator **Chafee**. Surely.

Mr. **Frenzel**. Mr. Chairman, I can't help commenting on some of the testimony that has just been given here. Over in the House, when it is unpopular to talk about closed rules, we call them modified open rules. I must tell you that I have the same modified open mind that Don Lubick has about this particular subject. [General laughter.]

I will go a little further and say, if you want to hear some anecdotal evidence, just listen to Lubick's defense of the 15 percent withholding on interest and dividends, and you will have heard a master of the anecdote.

Mr. Chairman, I have been interested in this act since I and others in the Congress made the mistake of cutting back on the 911 provisions in the 1976 Tax Reform Act. It is true, there was an excess of zeal for equity at that time. Congress did not stop to bother about competitiveness, as we certainly should have done.

Since then, we have seen American businessmen coming home in droves because their employers could not afford to keep them abroad, and it became cheaper to hire the Swiss or the British or the Frenchman or whoever over there. And we have seen American contracts diminish in construction, which is the most obviously affected industry.

Mr. Chairman, I hope this subcommittee and your committee will not be ensnared in the trap that Mr. Lubick has laid for you of only looking at some parts of the problem. That is what we did in 1978 with the Ribicoff amendments. These amendments were a great improvement, but mostly they were a great improvement to enrich tax accountants and lawyers.

I recently had the opportunity to take a look at the forms provided by the Internal Revenue Service to handle 911 and 913. I would have brought them home from Japan where I looked at them, but they would have made me overweight, and I couldn't afford to bring them.

Obviously, we don't need complexity. We need some simplicity in this law, and I think your bill is a good one. It's not quite as good as mine, Mr. Chairman——

[General laughter.]

Mr. **Frenzel** [continuing]. But it is excellent.

One more thing I might say. One of Mr. Lubick's anecdotes was the so-called pleasure dome argument. He would picture American businessmen abroad as relaxing on the shores of a swimming pool, having scantily clad maidens peel grapes for him and plop them in his mouth.

It isn't all that much fun to go even to the fancy cities of the world. I visited Americans working in Brussels, Paris, Geneva, and Tokyo, some of the nicer cities, and it is not that big a deal. Americans don't want to go abroad. They go abroad because it is part of their career development, and they do it because their employer sends them there. To have a representative of our Treasury tell us that these people are having some sort of a good deal that is better than Houston or Providence, I think, is a gross distortion of the facts.

I believe that most of our employees would be much happier working in Providence or Houston than having to absorb some of those higher costs abroad.

Mr. Chairman, I am delighted you are holding these hearings. I think it is very important. It brings out the results of the Chase study. I am delighted that the joint committee has provided you with a booklet that gives you the figures of somewhere between $400 million and $600 million of cost. If indeed the Chase study is anywhere near accurate—and Mr. Lubick is correct, it is probably not on a wholly factual basis—take away half of it, and it is still a gross profit to the United States to get rid of section 911 and to improve section 913, and to exempt from income taxes to the United States income earned by Americans abroad.

Thank you, Mr. Chairman.

Senator **Chafee**. Thank you, Mr. Frenzel.

Mr. Symms?

STATEMENT OF HON. STEVEN D. SYMMS, A U.S. REPRESENTATIVE FROM THE STATE OF IDAHO

Mr. SYMMS. Thank you very much, Mr. Chairman. With my two colleagues here from the House, I am delighted to have the opportunity to be here with them as a cosponsor of the Frenzel bill, to present testimony on this side of the Capitol, and I might also say, Mr. Chairman, I am glad to start getting acquainted with the surroundings over here, because I hope to be joining you in November. [General laughter.]

I think you covered the subject very well. The Chase study indicates a decline in U.S. exports and accompanying $6 billion tax loss in revenue, because of current tax policy. It astounds me that Treasury establishes a policy which according to the Chase Econometric Studies shows that they are losing revenue. The present tax system is actually a tariff imposed by our Government on the export of American products.

I think this is obviously in conflict with the administration's own policy, they say they want to increase exports, but they are actually imposing a tariff which makes it less expensive to hire workers from other countries. Reducing our presence in recent years has caused the United States share in world markets to drop from 23 percent to 14 percent in the last decade, and the United States is the only nation that taxes the incomes earned by its citizens working in foreign countries.

I think to bring it closer to home, Boise, Idaho, is the world headquarters of the international construction company, Morris & Knudson. Presently, they are in the process of bringing home many of their American employees, because they can no longer be competitive overseas with American employees.

That compounds the situation here at home as far as unemployment is concerned, and if you just take a look at any financial newspaper or newsletter, you can see that in construction dollars overseas, we are drastically hurting, and there was a time in the very recent past when the United States was the No. 1 builder around the world in foreign construction jobs, and I think it is a shame that that privilege is not being able to be continued by the entrepreneurial engineering ability of Americans.

The U.S. engineering and construction industry's share in the Middle East market has dropped from over 10 percent, to less than 1.5 percent. Worldwide, we have dropped from first place in contract awards among competing industrial nations in 1976 to seventh place as of the quarter ending in March 1980 for a 4.9-percent share of world construction in 1979 as compared with 16 percent in 1976.

Now, these statistics alone, which are indicative of only one industry, should force the United States to realize the principle that the Americans overseas direct business and therefore jobs back to the U.S. domestic economy, and a decline in that share of the market will only mean a decline in the available jobs at home.

Furthermore, I believe that besides economic benefits, there are other benefits overseas: Political benefits that we reap by having Americans overseas as representatives of good will of the United

States. Decreasing our presence will potentially damage our future influence in the Middle East and in other areas of the world.

The shift of declining American presence is going to cost our nation not only economically, but it will cost us in vital interests, influence, and security in future years.

I praise you for having these hearings and for moving forward toward solving this problem. I pledge my support to your efforts and to those of Congressman Frenzel in creating tax incentives that will benefit our nation in increased tax revenues and more jobs at home, and which will insure the protection of our vital interests, influence and security around the world.

Senator **Chafee**. Thank you very much, Mr. Symms.

I must say, those statistics that MK has brought back all their people is startling. I am familiar with the firm having seen their construction work all over the world. It is amazing.

Mr. **Symms**. Mr. Chairman, they have just built the big city in Saudi Arabia which has been so much talked about, and there are people left at this time, but many of the workers are coming home, and they are being forced to hire people from other countries.

Senator **Chafee**. And they attribute it to this act here?

Mr. **Symms**. Well, in an effort do make a comparison, I think, the take-home pay for an employee, from Switzerland compared to the United States—I don't have these figures right at my fingertips, but if I recall what was given to me, an American firm would have to pay an American employee about $60,000 a year in salary so that they can get the same take-home pay as, say, a Swiss worker that is being paid $36,000 a year.

So, that makes it impossible for an American construction firm to use American employees overseas and still remain competitive.

The Treasury with their modified open mind, or closed mind, as we would call it, is in fact denying the U. S. Treasury the revenues that they would otherwise get, because they are forcing these companies to hire foreign people.

Senator **Chafee**. Thank you very much.

Mr. Royer, we are delighted you are here. We appreciate your coming.

STATEMENT OF HON. WILLIAM ROYER, A U.S. REPRESENTATIVE FROM THE STATE OF CALIFORNIA

Mr. **Royer**. Thank you very much, Mr. Chairman.

I want to thank my colleagues and you for giving me just a moment to indicate my support. I did not come with a prepared statement. I have had the opportunity, however, to read both of my colleagues' statements. I would like to ask unanimous consent to associate myself with their remarks, and I would also like to indicate to you that I do have several firms within my district in San Mateo County, Calif., that are very vitally affected by the present tax laws. I can tell you that the information that I have received is very much the same as what you have, and certainly I would like to commend you for the work that you are doing in this area. I pledge my support to your efforts.

Senator **Chafee**. Fine. Thank you.

Mr. Frenzel, just today we chatted a little bit about the progress in the House. The full committee, Ways and Means Committee, would have to take this up. Is that the procedure?

Mr. **FRENZEL**. That is a question that I can't answer, Mr. Chairman. In previous years it has been referred to the Committee on Select Revenue Measures, Subcommittee, that is, headed by Congressman Rostenkowski. However, the cost effect of this might mean that it is beyond that subcommittee's capabilities, given the current budget situation, and so it might have to go to the full committee for consideration. I don't really know, but it does not occur within the jurisdiction of the Trade Subcommittee.

Senator **CHAFEE**. Does the full committee hold hearings?

Mr. **FRENZEL**. Normally, the hearings would be held in some subcommittee, probably Congressman Rostenkowski's subcommittee.

I have requested hearings, Mr. Chairman, and the chairman of the full committee has indicated that as far as he is concerned, he would prefer that they be held next year rather than this year.

Senator **CHAFEE**. I got the impression from talking to the chairman that he was sympathetic toward this measure.

Mr. **FRENZEL**. I think that is my impression as well, but at that time he was traveling, I think, under the idea that the administration was also resisting very vigorously any kinds of tax cuts or major tax bills this year. We see that that may be changing, and I think because of that I am going to reapproach the chairman and see if he isn't willing to accelerate the hearing schedule.

Senator **CHAFEE**. It would certainly be helpful, I think, if you could have some hearings over there. I think if we can get it through here, then you would have something there.

Mr. **FRENZEL**. Well, we would appreciate any encouragement or stimulus you could give us.

Senator **CHAFEE**. Well, we will press ahead here.

I want to thank you very much, all of you gentlemen, for coming over.

Mr. **FRENZEL**. Thank you, Senator.

[The prepared statements of the preceding panel follow:]

STATEMENT BY HON. BILL FRENZEL

Mr. Chairman, I first want to commend you and your fine Committee for holding these hearings. I believe Section 911 and 913 of the Tax Code represent a critically important aspect of the country's economic future. The House Ways and Means Committee, despite plenty of requests, has been unwilling to look at this subject this year.

In 1978, this Congress recognized, in what has come to be known as the Ribicoff amendments, that it has made a dreadful mistake in reducing the foreign exemption in 1976. Even by 1978, only two years later, it was apparent that we had shot ourselves in our collective foot in the 1976 Act.

In our excessive zeal for tax reform, we forgot about, or perhaps we never knew about, competitiveness abroad. Our own mistakes were compounded by some grotesque Treasury rules that imputed high income for expenses of living in miserable circumstances abroad.

Those 1978 amendments took care of some of the very worst Treasury rulings and helped to compensate Americans abroad for extraordinary living expenses. But they carried with them an awful price in administrative complexity and cost, and they did not address the central problem.

The real problem is, of course, that the U.S. is the only major trading country to tax the earned income of its citizens who are working outside of its borders. Thus, for U.S. companies, U.S. nationals are far more expensive than are foreign nationals.

Therefore, the goods and services of U.S. companies abroad are not competitively priced unless the U.S. companies hire foreign nationals. The problems are extreme for services, such as construction, which have a high American supervisory labor cost component. But Section 911 also poses cost difficulties for any U.S. firms who want to have Americans selling American exports in foreign countries.

The 1976 changes have caused Americans abroad to be brought home in droves. These Americans have been replaced by foreign nationals. These foreign nationals are undoubtedly good people, but experience proves that they do not order American products instinctively as an American would, and they do not instinctively place American interests first.

In short, since 1976, a number of us in Congress (a number which is now thankfully growing) have warned that U.S. export business was being lost because of the unwise tax policy in Sections 911 and 913 of the Internal Revenue Code. We warned about continuing trade deficits, and the effect on unemployment here at home.

Finally, we are able to describe those warnings in more definite terms because of a recently completed study by Chase Econometrics. The Chase study reinforces the generally accepted belief that the tax which the United States places on its citizens abroad is forcing many American exporters to replace their U.S. employees with foreign nationals whose income is not subject to tax by their native country. These individuals are likely to purchase products from their home country, as opposed to purchasing American made products.

The study determined that the current tax treatment of Americans abroad has resulted in a drop of at least 5 percent in exports in 1980. Chase estimates that this decline will raise domestic unemployment by at least 80,000, and reduce Federal tax receipts by more than $6 billion. This is many times the estimated $279 million a total exemption of foreign earned income would cost the Treasury.

Sections 911 and 913 are also placing an unnecessarily onerous burden on American charitable efforts abroad. Just as U.S. nationals are too expensive for American corporations, so too are they too costly for church missions, charities, agricultural foundations, etc. Our humanitarian and spiritual efforts abroad are being hampered as much as, or more than, our trade efforts.

Because of these conditions, on September 7, 1979, I introduced legislation (H.R. 5211) to do away with taxation on income which is entirely earned abroad. If it could be passed, I believe that the Yankee traders could again go abroad and compete fairly. Since that time, four similar bills have been introduced in both the House and the Senate, and several studies have been completed. The many cosponsors of H.R. 5211, and especially Mr. Jones of Oklahoma, agree with me that it is now time for the Congress to take action to remove the inequities in the tax laws pertaining to overseas Americans, in order to restore American competitiveness abroad.

STATEMENT BY CONGRESSMAN STEVEN D. SYMMS

Mr. Chairman and other Members of Committee, it is a pleasure to have the opportunity to submit testimony to this Committee on this side of the Capitol. It is a side which I expect to join next November and I am trying to familiarize myself with your surroundings.

I would like to thank the Members of the Senate Finance Committee for recognizing one of the major reasons for the declining U.S. competitiveness in the world economy. As you may know, I have co-sponsored Congressman Frenzel's bill in the House which would exempt from taxation the earned income of certain individuals outside the United States. A recent study by Chase Econometrics Associates, Inc. showed a 5 percent decline in the U.S. exports, and an accompanying $6 billion tax revenue loss to the Treasury as a result of the 1978 amendment on overseas taxation.

The present tax system is in actuality a tariff imposed by our Government on the export of American products. This tariff is aiding other industrialized nations with whom we compete to increase their share of the market at our expense. Since this tariff is substantially contributing to the decline of American exports, the current tax policy is actually increasing our unemployment rate in the United States by reducing the number of jobs that flow from exports created by the presence of Americans abroad and by increasing the number of workers in the workforce within the United States because of the financial necessity of bringing home Americans working abroad.

Common sense should dictate that if we want to sell our wares, we are going to have to go out and develop our markets. Hoping that buyers are going to come to our doorstep to purchase our goods and services will only result in a decline of our exports. American trade is dependent on increasing our visibility and credibility in the marketplace. Reducing our presence in recent years has caused the United States' share in the world markets to drop from 23 percent to 14 percent in the last decade. Continuing tax policies that forces American firms to withdraw their presence in overseas markets will further contribute to that decline.

The United States is the only nation that taxes the incomes earned by its citizens at work in foreign countries. American firms have found that it costs substantially more to employ Americans overseas than it does to employ citizens of other nations. In fact, Morrison-Knudsen, a major international firm based in Boise, Idaho, recently called home all of its American employees working abroad because of the disincentives in our current tax system to make it financially worthwhile to keep their American employees overseas.

The U.S. engineering and construction industry share in the Middle East market has dropped from over 10 percent to less than 1.5 percent. Worldwide, the U.S. has dropped from first place in contract awards among the competing industrial nations in 1976 to seventh place as of the quarter ending in March 1980 for a 4.9 percent share of worldwide construction in 1979 as compared with 16 percent in 1976. These statistics alone, which are indicative of only one industry, should force the United States to realize the principle that Americans overseas direct business and therefore jobs back to the U.S. domestic economy. A decline in our share of the market will only mean a decline in available jobs at home.

Furthermore, besides the many economic benefits of having an American presence abroad, there are political benefits as well. Decreasing our presence will potentially damage our future influence in the Middle East and other areas of the world. The shift of declining American presence will cost our nation, not only economically, but it will cost us in vital interests, influence and security in future years.

Americans must have the incentives to work overseas be reinstated. They must be on the same tax basis as the citizens of competing industrialized nations. Creating tax incentives will benefit our nation in increased tax revenues, more jobs at home and it will aid to increase and assure the protection of our vital interests, influence and security around the world.

Statement by Hon. Bill Royer

Mr. Chairman, it is a pleasure to be here with you today; I appreciate the opportunity to present a statement on the issues that the Subcommittee is considering. As you know, America's trading position is under serious attack. Clearly, the problems you are reviewing must be resolved if America is to continue to be a significant trading power in the world.

Accordingly, as American dollars continue to hemorrhage overseas due to our enormous oil bill (a problem which we have done little to resolve since the oil embargo) we must find ways to ensure that we are exporting all we can to other parts of the world in order to establish a favorable trade balance.

Specifically, many of us have looked at the tax changes that were made in 1976 and 1978 (Sections 911 and 913) and concluded that they are counter-productive to the goals cited above. The statistics over the last few years are truly alarming in terms of trade:

Over the last three years the U.S. balance of trade deficits have amounted to $100B.

In 1975 U.S. construction and engineering firms ranked first in the Middle East; in 1979 they were twelfth. Moreover, in 1975, U.S. firms in the Middle East had a 10 percent share of the market, while in 1979 they had only 1 percent.

Worldwide these same firms now rank seventh in terms of share; in 1976 they ranked first.

While it is true that the drop in America's world position is not totally based upon the tax problems posed by Sections 911 and 913, it is clear that they are significant disincentives to American firms operating overseas. Of course, what is particularly discouraging in this regard is that no other important trading nation in the world taxes its citizens working overseas. Encouraging firms to work overseas is not only good economics, but it is good politics as it creates jobs at home. Moreover, there are certain intangible benefits that accrue when Americans work overseas. There has always been a streak of isolationism in the American character, and thus to the extent that Americans work overseas, better understanding between peoples is fostered, reducing unwarranted fears and suspicions.

Located in my district is the international headquarters for the Guy F. Atkinson Co. I spoke with Atkinson executives about the effects of the 911 and 913 provisions on their ability to do business overseas. They informed me that in 1975, before the tax changes went into effect, the company submitted four bids for a total of $358M.

They obtained one amounting to $200M. In 1979 the company submitted bids totalling $636M, but did not receive one order. Once again, it is difficult to lay the blame totally on the 911 and 913 sections, but top management at Guy F. Atkinson informed me that these tax laws are having a significant impact on their ability to perform overseas.

Interestingly enough, certain policies of the company, though clearly patriotic, also restrict its ability to operate overseas. Evidently the company has no program to recruit foreign nationals to work in white collar positions on Atkinson projects overseas.

Other constituents are also very concerned about the problem. During the last six to eight months I have received numerous letters from constituents working overseas bemoaning the adverse impacts of the tax laws. I would like to share a portion of one letter that I received from one of my constituents, an executive for Bechtel's Refinery Group in Saudi Arabia. He wrote:

"After completing our assignment in Indonesia, we transferred to Bechtel's operations in Saudi Arabia, where my position encompasses all petroleum-related work throughout the Middle East. Upon my arrival, our American staff approximated 70 percent of our non-manual expatriate force or some 30 percent of the total force employed by Bechtel in the Kingdom. Subsidized foreign competition, most notably from the Koreans, and *unequal treatment of taxes on income compared to British, North European or Japanese nationals, have caused us to work aggressively to reduce dependence upon American staff and to bring in British, Northern European and Far Eastern nationals. The situation in the United Arab Emirates should be an object lesson for the United States of America. Under the domination of French, Dutch and Japanese interests our share of the market has diminished close to zero.*

"*It is estimated that one American working in Saudi Arabia generates fifteen jobs in the United States.* It is well-known that people who offer design services, such as Bechtel, tend to work with familiar codes, specifications and manufacturers. The diminishing U.S. presence means that less and less orders are placed in the United States and our "Balance of Payments" deficit widens. Those of us who work in the non-Defense area are acutely sensitive to the competition we see from Italy, Germany, France, The Netherlands and Britain. *If we could somehow eliminate the tax liabilities on foreign-earned income; on employer-supplied housing; on education allowances and on other pay offsets, the U.S. worker is competitive against the North European or Japanese.*" (Italic added.)

While admittedly the evidence is anecdotal, it is representative of numerous letters that I have received. Something very wrong is clearly happening to American firms trying to operate overseas.

Mr. Chairman, I commend your efforts to arrive at some solution to the problems caused by Sections 911 and 913. The evidence is clear and convincing; we seriously weakened our trading position by enacting Sections 911 and 913 and to ignore the problem for long is at our own peril. American industry is the most technologically advanced and employs the most competent people in the world. However, the world is different from the 1950's and 1960's when American industry was predominant almost as of right. It is not so much that America has declined (though there may be some of that), but that the other countries have caught up. In the future America must trade more aggressively as these other countries now do. It simply makes no sense for this government to send American industry into the world with one arm tied behind its back to bid on competitive contracts. Mr. Chairman, I urge swift action on the legislation which you are considering.

Thank you.

Senator CHAFEE. Mr. Dickey, who is representing the President's Task Force on Export Matters—that is the Wright Jones Commission?

Mr. DICKEY. Yes, sir.

Senator CHAFEE. Yes. Export Council. Well, thank you very much for coming, Mr. Dickey. I read over the report that your subcommittee came out with, and it is very, very helpful. And I read over your statement, too. Of course, you can wear two hats. You can wear both the Export Council hat and, of course, your hat as chief executive officer of Dravo, as well as your own personal experiences.

STATEMENT OF ROBERT DICKEY, CHAIRMAN, 911-913 TASK FORCE, THE PRESIDENT'S EXPORT COUNCIL

Mr. DICKEY. All right. I would be glad to respond to questions that might relate to that afterwards.

Dravo is an international engineering, construction, manufacturing, transportation, and natural resource company, headquartered in Pittsburgh, Pa.

I would like to say that I am grateful for the opportunity to appear before your committee on behalf of the President's Export Council.

As you may know, the Council is a group of more than 40 representatives of the private sector, Congress, and the executive branch. It was reactivated in 1979 to advise the President on export policy.

At an early meeting of the Council's Subcommittee on Export Expansion, representatives of the Treasury Department briefed us on a number of export policy issues. On the subject of 911-913, their contention was that the problem had, "of course"—their words—been taken care of.

The members of the Council in attendance were astonished to hear such cavalier treatment of an issue many of us consider to be one of the most serious problems facing American businessmen doing business abroad.

The result of a discussion following the Treasury briefing was the establishment of a special task force on 911-913 within the Council. The report of the task force contained three major recommendations on the IRS interpretation of the 1978 law, and emphasized the need for remedial legislation. A copy of the report, presented to President Carter and members of his Cabinet and all Members of the Congress, is submitted for the record of this hearing.

Generally, I would judge that congressional reception has been positive. Unfortunately, that judgment cannot be extended to the administration, where our recommendations were received with skepticism. And Treasury remained unconvinced on the fundamental issues that our taxes on overseas income and allowances have an impact on American exports.

The President's Export Council believes, as the report of our task force indicates, that the need for corrective legislation is clear, and that further delay for additional study and evaluation is both unnecessary and destructive. The longer we delay, the longer this particular export disincentive will be at work.

As my statement for the record indicates, our own experience at Dravo convinces us that 911 has resulted in a loss of business. Though we now operate worldwide, Dravo has traditionally been an American company staffed largely by American management. It has now developed that, except in instances where U.S. technology is essential and required, we are virtually excluded from projects calling for significant, long-term assignment of management talent because of the prohibitive cost of locating U.S. personnel abroad.

Foreign purchasers of engineering construction services are sophisticated consumers. Like businessmen everywhere, they are interested in holding vendor expenses to a minimum, and they are succeeding by eliminating Americans from projects they control.

About 18 months ago, I was in Saudi Arabia, and we were discussing with a member of the Royal Commission a new project on which we were bidding. He asked how many Americans would be present. We said about 100 to 150. He said, "That is all right for the first year, but at the end of the first year, I want that reduced to one-third." This is a direct quote, "We are not going to pay your taxes."

I think there is a dichotomy there. They want to do business with us, but we make it very difficult for them. I was there just this past month, in May, and again in a meeting with a member of the Royal Commission. He made the gratuitous remark that may be anecdotal, as Mr. Lubick said, but, nevertheless, he said our tax had cost us about $8 billion because of the loss of business they had been given. That is not Dravo; that is the United States.

When companies in our business are successful in booking foreign work, we create significant benefits for the American economy as a whole. A single 3-year Dravo project in Indonesia resulted in a peak employment of 150 additional people in Pittsburgh. New projects in Saudi Arabia and Mexico resulted in a search that began last December which will add 205 engineers and technical people to our headquarters' payroll in Pittsburgh.

Add the procurement opportunities created by projects of this magnitude, and the importance of contract bookings beyond our borders becomes obvious.

Because of the current tax envivonment, our industry is not given full reign to capitalize on the opportunities before us.

Contrary to the opponents of change to the existing law, Dravo's experience has been that current taxation policies inhibit our ability to secure foreign work and, when we have been successful, restricts the employment of Americans.

Finally, I think it is important to relate the specific subject of these hearings to an overall need to regard exports in the broader context and view them as a matter of national policy. Council Chairman Reginald Jones reminded us recently that the major trading countries of Europe and Japan live by the precept, "export or die".

It is inconceivable that any of these countries would impose a 911-type law on its own citizens who work overseas. Exports are no less vital to America's national interests, yet we are the only major trading company in the world whose activity abroad is restricted by 911-type law.

The problem is finally before us. While 911-913 is a small part of the bigger picture, if we can make progress on this one issue, we will be one step closer to our collective goal of restoring America's competitive strength in a global economy.

I want to thank you for the opportunity to appear and for your assistance in what we consider a very vital need.

Senator **Chafee**. Thank you very much, Mr. Dickey.

I would like to ask a couple of questions. Since you are right there on the firing line, the man who is running a company that is involved in the very area with which we are deeply concerned, what is the effect of your decision to cut your costs by not hiring Americans? So what then do you do? You hire French, Brits?

Mr. **Dickey**. Yes. We are recruiting teams in Europe right now for projects in the Far East and the Middle East.

Senator **Chafee**. Now, there is a loss of jobs. What is the loss of orders in U.S. equipment, in other words, the export side of it?

Mr. **Dickey**. I think I can testify essentially that a lot of our business overseas is the startup, operating, and training of personnel as compared to a brand-new project. We are bidding on one right at this moment where we will have 11 Americans out of 60 top management people. Historically it has been our experience that those people do tend, as you get into the maintenance aspect, to revert to products of their own country.

I can't put a dollar value on it, but certainly those managerial types have the authority and do seek familiar equipment.

Senator **Chafee**. Well, for instance, who would order the tractors and bulldozers?

Mr. **Dickey**. On a major construction job of that type, it would probably be specified in your original estimate, and we could probably control that. It is when you get into a maintenance, ongoing kind of a project where you might have a 3-year duration just operating a particular facility for the Saudis or the Indonesians or others.

Senator **Chafee**. You mean, you build a powerplant.

Mr. **Dickey**. Then you might operate it for 3 years for them, or a chemical plant, or a salt plant, as we are doing in Algeria.

Senator **Chafee**. All right. So you build a chemical plant, and then——

Mr. **Dickey**. Over a time, if that staff was foreign, non-Americans, they tend to order back to those countries, because they are ordering small replacements that are not part of the original bid or estimate.

Senator **Chafee**. Now, if you had Americans there, they would tend to order American equipment?

Mr. **Dickey**. Certainly they would order familiar equipment. The dollar differential isn't that great in many cases.

Senator **Chafee**. Well, thank you very much. Now, I think that the Export Council is a wonderful help in all of this, because it is composed of very prestigious people who have had a lot of experience, and I saw your report. What happened? Are you hurt?

Mr. **Dickey**. We are hurt. It is very difficult to talk about the jobs you don't get, but it certainly costs us between 20 and 50 percent. I have some direct examples in putting an American manager of the same base salary, same allowances, in the field. To a man with a base salary of $46,000, for instance, we are paying, on a tax equalization basis, about $24,000 a year extra to equalize his taxes.

Senator **Chafee**. You mean, in addition?

Mr. **Dickey**. In addition. To put it another way, the total cost of putting that man in Saudi Arabia, counting housing and all allowances, is $114,000.

Senator **Chafee**. For a $46,000 man?

Mr. **Dickey**. His base. Now, he gets a 35-percent premium, as does the Englishman of the same salary. So I am comparing apples with apples. But in addition, on a 2-year basis, it was $43,867. That is a specific live example. And that is a medium manager, not a top level manager over there.

So, on the jobs that have a high labor content, a high management content, you are paying a premium to put an American in the field, on a tax equalization basis, of something on the order of 20 percent and, as he gets more pay up to almost 50 percent.

Senator **Chafee**. Fifty percent, setting aside housing and things like that?

Mr. **Dickey**. This is including the total package. It is 50 percent of that total amount.

Senator **Chafee**. Well, let's take an example. You are going to fill a job.

Mr. **Dickey**. All right.

Senator **Chafee**. And you have an American who has the qualifications. To have him over there would cost you what, $114,000?

Mr. **Dickey**. $114,000 for both of them, either one of them.

Senator **Chafee**. I see.

Mr. **Dickey**. In addition, we would pay tax equalization of approximately $22,000.

Senator **Chafee**. To the American.

Mr. **Dickey**. To the American.

Senator **Chafee**. So you add that on top of the $114,000?

Mr. **Dickey**. Exactly. That is where I got my roughly 20 percent.

Senator **Chafee**. Yes. So it is costing you $136,000——

Mr. **Dickey**. That is right.

Senator **Chafee** [continuing]. To hire somebody that you could have a Brit there for $114,000?

Mr. **Dickey**. Paying him the same salary.

Senator **Chafee**. Paying him the same salary.

Mr. **Dickey**. For productivity and salary, there is no difference there.

Senator **Chafee**. I see. Would the Brit come at a lower salary in addition to that?

Mr. **Dickey**. You could fill that same job, because their scale of pay is somewhat lower, at a little lower price.

Senator **Chafee**. You start off with a differential that you expect to overcome?

Mr. **Dickey**. Right. I didn't want to exaggerate the picture, but that is true.

Senator **Chafee**. Another point that I think we should make here for the record is that when you don't have your people at the desalinization plant or the chemical works or whatever it is, you lose those orders then but you might lose future orders, too, by the fact that you don't have the equipment, so thus you don't have the spare parts that would come from America. It goes further than this year. It extends out into the future, too, doesn't it?

Mr. **Dickey**. Absolutely. A very good example, as I say, I was there a month ago. We did not build Riyadh No. 5 powerplant, but we did have responsibility for the startup, operation, and maintenance of it, and we are still working on it. It was a very sophisticated type of plant, in that it burned, in a turbine, crude oil without any refining, which eliminates the need for water and other things. It is a large, 800-megawatt plant.

Riyadh No. 7, which we designed and bid on the same operating basis, we lost to an English firm because we had proven that it could be done on the first project and they didn't need to pay any premium for our technology on the second plant. That has happened within the last 5 weeks.

So, you lose ongoing. If you cannot sell exclusive technology at a given moment, you are at a competitive disadvantage. Ultimately, if you reduce, as we are doing on a job we are bidding now, we are bidding with 11 Americans and 49 non-Americans, you finally lose the position of being an American company in terms of their looking to do business with you.

Senator **Chafee**. Well, thank you very much, and thank you also for your work on the Export Council. We appreciate it.

[The prepared statement of Mr. Dickey follows:]

Testimony
Robert Dickey III
Before Subcommittee on Taxation;
Senate Finance Committee
June 26, 1980

Mr. Chairman, and members of the Committee:

My name is Robert Dickey. I am the Chairman and President of Dravo Corporation, an international engineering and construction, manufacturing, transportation and natural resources company, headquartered in Pittsburgh, Pennsylvania.

I am grateful for the opportunity to appear before your Committee today on behalf of the President's Export Council. The Council is a group of more than forty (40) representatives of the private sector, Congress and the Executive Branch. It was reactivated in 1979 to advise the President on export policy.

At an early meeting of the Council's Subcommittee on Export Expansion, representatives of the Treasury Department briefed us on a number of export policy issues. On the subject of 911-13, their contention was that the problem had, "of course," been taken care of. The members of the Council in attendance were astonished to hear such a cavalier treatment of an issue many of us consider to be one of the most serious problems facing American businessmen doing business abroad.

The result of a discussion following the Treasury briefing was the establishment of a special Task Force on 911-13 within the Council. I served as Chairman of the group with excellent support from John Wood Brooks, of Celanese, D. Commons, of Natomas, and Maurice Sonnenberg, an investment consultant.

Over a period of several months, our Task Force made a study of the current treatment of 911-13. We consulted with Government, and with corporations heavily engaged in international trade; and our research involved such organizations as the U.S. and Overseas Tax Fairness Committee, and the American Citizens Abroad of Geneva, Switzerland. Subsequently, a report of our findings was unanimously approved by the Council's Subcommittee on Export Expansion and, later, by the body's Executive Committee with but a single change--that remedial legislation provide up to and including full exclusion of income earned abroad.

Our report contained three major recommendations:

1. Regulations under 911 concerning Americans living in hardship areas should be simplified and made less restrictive;

2. Section 913 provisions concerning allowances for excess living costs should be interpreted in the least restrictive and simplest manner;

3. We should immediately encourage enactment of a new tax law to put Americans working overseas on the same tax footing as citizens from competing industrial nations.

Additionally, the report included a detailed chart showing a comparison of United States tax treatment of expatriate foreign earned income with policies in effect in other industrial nations. At a glance, the chart provided a clear reading of the wide discrepancy in approaches to taxation among nations which compete for international business.

The President's Export Council Chairman, Reginald Jones, presented the Task Force report to President Carter and members of his cabinet on December 10, 1979. The report was distributed to all members of the Congress and inserted in the Congressional Record by both Senator Long and Congressman Ullman. A copy of the report is similarly submitted for the record of these proceedings. Mr. Jones formally presented the report to a special meeting of the Senate Export Caucus and personally discussed the matter, on a number of occasions, with Treasury Secretary Miller, a member of the Council. Generally, I would judge that Congressional reception has been positive, but not necessarily enthusiastic.

Unfortunately, that judgment cannot be extended to the Administration, where our recommendations were received with skepticism. And Treasury remains unconvinced on the fundamental issue: that our taxes on overseas income and allowances have an impact on American exports. Reflecting the Administration's position, President Carter sent a report to Congress on January 24 which made three basic points:

1. There is as yet no clear evidence that U.S. taxation of Americans abroad brings competitive advantage;

2. The 1978 law hasn't been in effect long enough to reveal its true revenue and economic effects;

3. Therefore, let us wait and see and do nothing until we have more facts.

The position not only demonstrates a lack of concern about the impact of the law, but is based on a faulty reading of our report. Its message includes a statement that the Task Force report assumes a tax exemption would lead to reduced export prices for U.S. goods, thus increasing demand. That claim was made by no Council member, and is neither explicit nor implicit in our report.

The President's Export Council believes, as the report of our Task Force indicates, that the need for corrective legislation is clear and that further delay for additional study and evaluation is both unnecessary and destructive. The longer we delay, the longer this particular export disincentive will be at work.

In my judgment, there are two key considerations on the 911 issue:

First, I believe there is now general agreement among informed people that the Congress should act promptly to eliminate--or, at least, to reduce--the harmful effects of as many of our self-inflicted export disincentives as possible. We can all quote the distressing details of the dire state of our world trade situation. The merchandise trade deficits were in the $30-billion-per-year range the past three years, and current projections are that deficits in 1980 and 1981 will be even worse.

In seeking the means to improve U.S. export performance by reviewing the various U.S. self-imposed export disincentives, however, we must also acknowledge that some of the disincentives are tied to circumstances which resist reform. Some export disincentives arise in connection with, or result from, programs and policies to implement and advance such U.S. foreign policy objectives as improvements of human rights, freer emigration from Communist countries, the reduction of questionable foreign payments, and more.

The 911 export disincentive does not materially affect foreign policy objectives and, therefore, is perhaps the easiest one for the Congress to deal with. At worst, a small, short-term revenue loss might be incurred, though that is by no means certain. But any such momentary loss is clearly outweighed by the pressing need to develop a more effective U.S. national export policy. Instead, as improvements in an overall U.S. export policy lead to a corresponding increase in the sale of American goods and services abroad, tax revenues will also increase. This view is supported by a recent study performed by Chase Econometrics which I understand will be discussed with you later today.

My second point is in response to those who argue that the U.S. should not liberalize 911 unless we can present a large number of actual cases, each identifying a U.S. exporter who can prove that he lost export business solely because of 911.

There is no question but that the present limited nature of 911, under the current 1978 law, has caused U.S. exporters to lose business. I understand you will be receiving specific testimony today on this point from some of the other witnesses. But it would be unrealistic to limit debate to restrictive cause-and-effect instances as the only argument valid enough to trigger reform. The basic facts should be reason enough for action. As a direct result of our current tax policies, it is considerably more expensive for an American firm to position an American citizen abroad than it is for competing companies based in Japan, Germany, Korea or the United Kingdom. All four nations provide full tax exemptions on foreign earnings. Compounding the situation are the low-tax and no-tax conditions that exist in many of our most active foreign markets. The Middle East nations of Saudi Arabia, Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates fall into this category, as do Argentina, Venezuela and The People's Republic of China. For Dravo Corporation and for many other companies, the first group of nations contains many of our most vigorous competitors, while the second constitutes our most important overseas markets. The combination of disincentives is a heavy burden to carry in the very competitive arena of engineering construction.

As that statement indicates, our own experience at Dravo convinces us that 911 has resulted in a loss of business. Though we now operate worldwide, Dravo has traditionally been an American company staffed largely by American managers. With others in our industry, we have learned that our essentially American orientation produces few benefits when seeking assignments abroad.

We began our overseas effort by bidding projects as we would at home; that is, with the intention of locating our own people in key management and technical positons. We learned quickly that, except in instances where U.S. technology was essential and required, we were virtually excluded from projects calling for significant, long-term assignment of management talent because of the prohibitive cost of locating U.S. personnel in overseas nations. Foreign purchasers of engineering construction services are sophisticated consumers; like businessmen everywhere, they are interested in holding vendor expenses to a minumum. And they are succeeding by eliminating Americans from projects they control.

We have adapted to market conditions. The results may surprise you. Of some 60 people slotted in management positions for an assignment we are presently bidding in Saudi Arabia, for competitive reasons, only 11 are expected to be Americans. The reason? Current taxation policies require us to pay a 20 to 50 percent premium in tax equalization over and above the total cost of locating foreign nationals with the same salary and allowances in that market. Profit margins in the competitive field of engineering construction are such that a premium of that magnitude for American managers results in a severe handicap.

For a number of reasons--maintaining an American presence, quality of performance, familiarity with Dravo's project approach, to cite just a few--we prefer to staff our assignments with as large an American contingent as possible. But our Saudi Arabia experience is not an isolated example. It occurs frequently when we compete with companies whose nations of origin apply a more enlightened tax policy to citizens working abroad.

When companies in our business are successful in booking foreign work, I should point out, we create significant benefits for the American economy as a whole. A single, three-year Dravo assignment in Indonesia resulted in a peak employment of 150 people in Pittsburgh. New projects in Saudi Arabia and Mexico resulted in a talent search that began last December which will add some 205 engineers and technical people to our headquarters payroll. Add the procurement opportunities created by projects of this magnitude and the importance of contract bookings beyond our borders becomes obvious. Because of the current tax environment, our industry is not given full rein to capitalize on the opportunities before us.

Contrary to the opponents of change to the existing law, Dravo's experience has been that current taxation policies inhibit our ability to secure foreign work and, when we have been successful, restrict the employment of Americans. To deny our contention, it seems to me, stretches the limits of basic common sense. And to ignore it, in company with the growing body of evidence detailing the effects of other disincentives, is to risk abandoning our nation's once-eminent positon in international commerce.

Finally, I think it is important to relate the specific subject of these hearings to an overall need to regard exports in the broader context and view them as a matter of national policy. To date, we have been more limited in our approach than present circumstances demand. Council Chairman Reginald Jones reminded us recently that the major trading countries of Europe and Japan live by the precept "export or die." It is inconceivable that any of these countries would impose a 911-type law on its own citizens who work overseas. Exports are no less vital to American's national interest. Yet we are the only major trading country in the world whose activity abroad is restricted by a 911-type law.

But the process of reform seems finally to be under way. There is today in Washington, and in our country in general, an awakening to the export problem. It can be seen in Congress, and in the national press, where editors and columnists are actually giving coverage to issues previously confined to the business pages. It is also demonstrated in public opinion polls and studies, where the man in the street expresses his concern about excessive government regulations and the "no growth" philosophy.

We have seen progress in the Congress over the past year. Both the House and Senate have established export caucuses to analyze and promote export expansion legislation. Last year's debate on the Export Administration Act and the resulting legislation was clearly a good-faith effort to respond to the serious concerns of the business community. The overwhelming support for normalizing trade relations with The People's Republic of China, and the approval of the multilateral trade negotiation agreements were also positive signs.

While this Administration has sought to come to grips with problems in the export policy area, there is much that remains to be done. The recent government reorganization, giving more policymaking responsibility to the United States Trade Representative and beefing up the Commerce Department, is a step in the right direction.

The National Export Policy Act bill (S2773) consolidates most of the proposed trade legislation on the Senate side, and, which I understand is sponsored by most of the members of the Senate Export Caucus, is a very encouraging objective. This act includes Senator Chaffee's S2283 on 911 and should serve to broaden the base for Congressional support for needed legislation.

However, we will not come close to resolving our international trade dilemma until trade and international economic policy are seen for what they are, essential to the national security of our nation, and to the economic well-being of all our citizens. Trade is not a special interest issue, but one that is absolutely central to the general welfare of the United States as a whole. Our standard of living, our levels of national employment and even our military security depend on America's economic strength in the world economy.

The problem is finally before us. And while 911-913 is a small part of the bigger picture, if we can make progress on this one issue, we'll be one step closer to our collective goal of restoring America's competitive strength in the global economy.

THE
PRESIDENT'S EXPORT COUNCIL

SUBCOMMITTEE ON
EXPORT EXPANSION

DECEMBER 5, 1979

REPORT OF THE TASK FORCE TO STUDY THE TAX TREATMENT OF AMERICANS WORKING OVERSEAS

THE PRESIDENT'S EXPORT COUNCIL
WASHINGTON, D.C. 20230

December 10, 1979

The President
The White House
Washington, D. C.

Dear Mr. President:

The Executive Committee of the President's Export Council has asked me to express to you its strong concern over the adverse effects on exports of the present rules (Sections 911 and 913) concerning taxation of foreign earned income of Americans living overseas.

The Foreign Earned Income Act of 1978 has done little to alleviate the problems of differences in tax treatment between American citizens working overseas and their counterparts from competing industrial nations. The result has been that third-country nationals, who generally do not have the burden of paying taxes in their home countries on their foreign earned income, are employed instead of American citizens. This has brought about a sharp loss in the U. S. share of overseas business volume in vital economic sectors, largely because third party nationals tend to specify equipment manufactured in their home country, whereas American citizens would specify and order U. S. equipment with which they are most familiar.

A particularly disturbing example is the decline in the position of American contractors on projects in the Mid-East. According to McGraw-Hill, U. S. companies had contracted for $8.9 billion or 10.3% of the total contracts let in the Mid-East from June 1975 through April 1978. During the 13 months ending in June 1979, U. S. contractors received only $346 million or 1.6% of the total contracts awarded. The loss of U. S. jobs both overseas and at home to foreign competitors, and the accompanying loss of U. S. expor comes at a time when it is crucial to maintain U. S. prestige and presence overseas and a firm emphasis on increasing our share of the world market.

The President's Export Council appointed a task force to study this problem. The following administrative recommendations, aimed at putting Americans who work in the private sector overseas on a more comparable tax footing with citizens of competing industrial nations, are adapted from this report.

- Regulations and interpretations in force under the current tax law concerning Americans living in camps in hardship areas (Section 911) should be simplified and made less restrictive, in keeping with the intent of Congress.

- The current tax law concerning allowances to employees for excess living costs incurred while working abroad (Section 913) should be interpreted in the least restrictive and simplest manner.

We have discussed these recommendations with Secretary Miller and would appreciate your endorsement of them.

The final task force recommendation is that work begin immediately to encourage enactment of new tax provisions directed to this problem. We have called upon a broad spectrum of the American export sector for comments on specific legislative points which would relieve the burden under which they now operate, and would be in the national interest.

I am sure it was not the Administration's intent, or that of Congress, to discourage the employment of Americans by U. S. business overseas. The tax law must be one that enables Americans to face the uncertainties of life abroad and serve as the leading edge of the export growth that is necessary if we are to maintain the leading economic role for the U. S. in today's world that is so essential to our welfare.

Respectfully yours,

Reginald H. Jones

Reginald H. Jones
Chairman

THE PRESIDENT'S EXPORT COUNCIL SUBCOMMITTEE ON EXPORT EXPANSION

Task Force to Study the Tax Treatment of Americans Working Overseas

I. THE SITUATION

Despite the enactment of the Foreign Earned Income Act of 1978, Americans are still being taxed out of competition in overseas markets. The result is a sharp loss in the United States' share of overseas business volume in vital economic sectors. The current situation contributes to our negative balance of payments, a loss of U.S. jobs to our competitors, and the decline in U.S. presence and prestige abroad.

II. TASK FORCE RECOMMENDATIONS

Americans working overseas are essential to a viable export program. An increase in the number of Americans assigned abroad can increase our exports, reduce the negative balance of payments, enhance our country's image, and raise employment in the U.S.

Recognizing that it is in the best interest of our nation to encourage Americans to work overseas, the Task Force recommends the adoption of tax policies that are comparable to those of major competing industrial nations, none of which now tax citizens who meet overseas residency tests. We urge the development and enactment of new legislation to put Americans who work in the private sector overseas on the same tax footing as citizens of competing industrial nations. In the interim, the following remedial actions should be taken:

1. Regulations and interpretations in force under the current tax law concerning Americans living in camps in hardship areas (Section 911) should be simplified and made less restrictive, in keeping with the intent of Congress.

2. The current tax law concerning allowances to employees for excess living costs incurred while working abroad (Section 913) should be interpreted in the least restrictive and simplest manner.

3. Work should begin immediately to encourage enactment of a new tax law to put Americans working overseas on the same tax footing as citizens from competing industrial nations.

III. BACKGROUND

Foreign Trade Encouraged

Beginning in the 1920's, after the U.S. emerged from World War I as a major exporting nation, the income earned by Americans at work in foreign countries was virtually exempt or excluded from U.S. taxes, as a matter of public policy and by specific acts of Congress. The purpose was to encourage foreign trade. It was recognized that the export of U.S. goods and services depended, in large measure, on the presence of Americans in overseas markets.

best copy available

The U.S. tax policy was not unique. All of our trading partners, and certainly all of the world's major producing nations, had long excluded income earned by citizens at work overseas from taxation.

In the early 1950's some revisions were made in the tax treatment of U.S. citizens working overseas. The principal aim was to halt abuses by highly paid movie stars. These revisions altered foreign residency tests and placed a ceiling on the amount of foreign-earned income that could be excluded. The income and allowances of most Americans working overseas was below the $20,000 limit, so they were not affected. They were not meant to be.

Additional technical adjustments were made during the 1960's in foreign residency tests and in the sums that could be excluded. By the mid-1970's, the effects of inflation — rising living costs and rising salaries and benefits for overseas American workers — had overtaken the amount of foreign-earned income that could be excluded from U.S. taxes.

Policy Shifts in 1976

Responding to misguided arguments that Americans overseas were being granted preferential tax treatment, Congress in 1976 reduced the exclusion to $15,000 and changed the manner in which it was computed so its maximum practical effect became about $3,000. The philosophy behind these provisions was directly contrary to the principles which had guided the United States' tax treatment of overseas Americans for more than 50 years. Instead of encouraging Americans to work overseas, the 1976 amendments actually discouraged such employment. In fact, even before the 1976 amendments, it was becoming less attractive to work overseas. Inflation was running at between 50 percent and 300 percent higher than domestic inflation, a fact that should have been recognized by increasing the $20,000 exclusion rather than decreasing it.

Further, the Tax Court ruled in 1976 that employer furnished housing was taxable to employees at full local rental value, rather than the value of similar housing in the United States. These rulings were interpreted as a strong indication that employer contributions to offset extraordinary overseas living expenses — or so-called "keep whole" contributions — were taxable to overseas employees, whereas such amounts often may have gone unreported up to that time.

These rulings, when combined with the 1976 tax code revisions, produced effects that Congress and the Tax Court did not foresee. For example, in the oil-rich Middle East, the costs to an employer of maintaining an American worker at something approximating the standard of living he or she would have enjoyed at home could exceed the actual salary paid to that worker by three or four times. As a result, some Americans overseas became liable for more taxes than they received in real income.

The 1976 tax policy shifts on foreign-earned income actually amounted to a substantial tariff on our own goods and services by our own government.

Foreign Earned Income Act of 1978

After belatedly postponing the effective date of the tax code revisions, Congress moved in 1978 to remedy the devastating mistakes of 1976 with the Foreign Earned Income Act. Unfortunately, the 1978 Act is inadequate. The House of Representatives had passed a realistic bill, but the law that was eventually enacted represents a compromise with a more restrictive Senate version. Section 911 of the Act provides a $20,000 exclusion for overseas Americans living in qualified camps in remote hardship areas. Section 913 provides deductions for certain allowances for extraordinary overseas living expenses under fairly strict qualifications. Both Sections 911 and 913 are very complex. Moreover, regulations drafted by the Internal Revenue Service under the new law effectively reverse the intent of Congress by compounding the complexities beyond reason.

Even if the Foreign Earned Income Act of 1978 is interpreted in the least restrictive way possible, it is clear that overseas Americans are not currently competitive with citizens of other nations in terms of taxes.

IV. RATIONALE FOR RECOMMENDATIONS

Americans at work overseas direct business to our domestic economy. If we are to increase exports in order to bring our trade accounts into balance, we must encourage more U.S. citizens to accept assignments with American business overseas. Concurrently, we must continue to be sensitive to the geo-political ramifications of having more Americans working abroad. Overseas employees of American business are seen as representatives of our country. Through their participation and visibility in international business affairs, they can function as goodwill ambassadors whose work exemplifies America's ideals and values.

To achieve these benefits will require, among other things, that current tax laws bearing on foreign-earned income be changed. At present, our nation's tax policies discourage the employment of Americans overseas. Many American companies doing business overseas, especially in the manpower-intensive service industries, are sending American employees home in order to keep some vestige of market share. For example:

- Recruiting firms in France, Germany, Italy and the United Kingdom report they are swamped with requests for qualified citizens of their respective countries to replace Americans who are being forced home by U.S. tax policies.
- Several leading U.S. contractors in the Middle East have reduced their American staffs by more than half, and adopted hiring policies overseas that specifically exclude Americans on future work.
- The University of Petroleum and Minerals in Saudi Arabia says Americans now make up less than 30 percent of its teaching staff, compared to more than 80 percent several years ago.

Replacing American employees with citizens of other countries is the only way American companies can remain competitive. This means that as U.S. companies operating overseas "de-Americanize," sales of goods and services move away from this country and toward the competing industrial nations.

- A report by the Government Accounting Office suggested that the impact of current U.S. tax policies for overseas Americans might be very significant — with a reduction of 5% or more of total exports or a loss in overseas sales of at least $6 to $7 billion, based on available data. And the GAO report cautioned that its projections might well prove conservative.[1]

---

[1] Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas, Report to the Congress, Comptroller General, February 21, 1978, page 10.

- The Commercial Counselor of the Embassy of Saudi Arabia recently observed:

> "U.S. tax treatment of American companies doing business in foreign countries makes them less competitive *vis a vis* European and Japanese (and other) companies, which receive better tax treatment from their governments. In the case of Saudi Arabia, it is noticed that American companies, in order to overcome the higher costs resulting from the unfavorable tax treatment, have tended to hire non-American engineers and other skilled personnel. Naturally, these prefer equipment and specifications originating in their countries (European or Japanese, etc.), which represent a loss in American exports to Saudi Arabia. Thus, the end result of U.S. tax treatment of American personnel working abroad has been a net loss of American sales abroad."

That means a loss of jobs in our economy. Estimates vary. Using the low end of the Department of Commerce estimate that for every $1 billion in new economic activity between 40,000 and 70,000 jobs are created, a loss of 5% of our current overseas export volume — or about $7 billion in economic activity — would produce a job loss of 280,000. Using the same Department of Commerce figures, if the U.S. decided on policies to increase exports by at least $30 billion annually as a means of bringing the trade accounts into balance, at least 1.2 million new jobs would result.

If we increase our nation's exports we will increase job opportunities for Americans at home and abroad. In order to achieve such improvement, we must re-assess our tax policies. We also must write new tax laws directed at placing Americans on a competitive footing with other nationals in overseas markets. (See Chart Below)

V. CONCLUSION

The principle underlying the taxation of Americans working in other countries should be to encourage, rather than discourage, employment with U.S. business overseas. The implementation of this principle through changes to the Internal Revenue Code will increase the number of U.S. citizens who are willing to work overseas, resulting in an increase in American exports.

Respectfully submitted,

Robert Dickey III
John Wood Brooks
D.L. Commons
Maurice Sonnenberg

December 5, 1979

Comparison of Tax Policies for Overseas Employees

Country	Tax on Salary	Tax on Incentive Bonuses	Tax on Benefits (Retirement, Health, Insurance, Etc.)	Tax on Cost of Living Allowances	Tax on Additional Income Earned Out of Home Country	Notes:	Government Subsidies (To Individual)
[illegible]	Yes[1]	Yes	Yes	Yes[2]	Yes	[1] 20,000 exclusion under Section 911 for those in qualified camps. [2] Certain deductions permitted under complex Section 913 tests.	No
[illegible]	No	No	No	No	No[1]	[1] Rental, interest, etc. on off-shore investments totally exempt from taxation during non-residence status only.	Yes
[illegible]	No[1]	No	No	No[2]	Complex formulas to discourage foreign investments	[1] Complex non-residency requirements. [2] Limitation placed on daily expenses for home leave and R&R.	Government owned companies
[illegible]	No[1,2]	No	No	No	Complex formulas	[1] Assumes accompanied tour/rules for dual residency—unaccompanied—very complex. [2] Recent government policy aimed to encourage more French engineers to accept overseas work.	Government owned companies
[illegible]	No	No	No[1]	No	No	[1] Most liberal policies with respect to individuals — Korea committed to exports of domestic unemployment.	Yes
[illegible]	No[1]	No[2]	No	No[3]	Some limitations. Generally liberal.	[1] Complex non-residency requirements aimed at tours of less than 6 months. [2] Complex definitions. [3] Some limitations designed to reduce excesses.	Few
[illegible]	No[1]	No	No	No	No	[1] Accompanied tour only. If family of head of household remains in Canada all worldwide earnings subject to full taxation.	No
[illegible]	No	No	No	No	No	[1] Recently liberalized tax policies in order to encourage acceptance of overseas assignments.	Few
[illegible]	No	No[1]	No[2]	No	Complex requirements	[1] U.K. recently liberalized tax policies in order to encourage. [2] Some limitations.	Few

Compiled from data provided in [illegible] and Statistics International S.A. [illegible] study, The [illegible]

PRESIDENT'S EXPORT COUNCIL
EXECUTIVE COMMITTEE

CHAIRMAN

Reginald H. Jones
Board Chairman and Chief Executive Officer
General Electric Company

VICE CHAIRMAN

Paul Hall
President of Seafarers International Union of North America

MEMBERS

Honorable Bill Alexander
Member of Congress

Morris M. Bryan, Jr.
President
Jefferson Mills

George D. Busbee
Governor of Georgia

Harry E. Gould, Jr.
Board Chairman and Chief Executive Officer
Gould Paper Company

Honorable Jacob Javits
Member of Congress

J. Paul Lyet
Board Chairman
Sperry Rand Corporation

Ms. Herta Lande Seidman
Deputy Commissioner
New York State Department of Commerce

Honorable Adlai E. Stevenson
Member of Congress

C. William Verity, Jr.
Board Chairman and Chief Executive Officer
Armco, Inc.

PRESIDENT'S EXPORT COUNCIL
SUBCOMMITTEE ON EXPORT EXPANSION

CHAIRMAN

Mr. Harry E. Gould, Jr.
Chairman of the Board
Gould Paper Corporation

MEMBERS

Honorable Bill Alexander
Member of Congress

Honorable C. Fred Bergsten
Assistant Secretary for
International Affairs
U.S. Department of Treasury

John Wood Brooks
Board Chairman
Celanese Corporation

D.L. Commons
Chief Executive Officer
Natomas Company

Robert Dickey III
Chairman and President
Dravo Corporation

Honorable Thomas S. Foley
Member of Congress

Honorable Kenneth Allen Gibson
Mayor of the City of Newark

Honorable John D. Greenwald
Deputy General Counsel
Office of the Special Representative
for Trade Negotiations

Dr. Kelly N. Harrison
General Sales Manager
Office of GSM
U.S. Department of Agriculture

Ernest B. Johnston, Jr.
Deputy Assistant Secretary
for International Trade Policy
U.S. Department of State

Honorable Stanley Marcus
Acting Assistant Secretary for
Industry and Trade
U.S. Department of Commerce

Ms. Joyce Dannen Miller
Vice President
Amalgamated Clothing and
Textile Workers Union

Honorable John L. Moore, Jr.
President and Chairman
Export-Import Bank of the
United States

Honorable Howard D. Samuel
Deputy Under Secretary for
International Affairs
U.S. Department of Labor

Ms. Ruth Schueler
President
Schueler and Company, Inc.

Ms. Herta Lande Seidman
Deputy Commissioner
New York State Department of
Commerce

Maurice Sonnenberg
Investment Consultant

Honorable Adlai E. Stevenson
U.S. Senator

EX OFFICIO MEMBERS

Mr. Reginald H. Jones
Chairman of the President's Export
Council
Chairman of the Board
General Electric Company

Mr. Paul Hall
Vice Chairman of the PEC
President, Seafarers International
Union of North America

Senator **Chafee**. Mr. Barnard? Now, gentlemen, I have contributed to the length of this myself. We have got a lot of witnesses to be heard; so, I guess we will have to be pretty strict on the time, because we have got folks who have come some distance and we want to hear them all. It is now 20 past 3. So if people could give brief statements, that would be appreciated.

Go to it, Mr. Barnard. We are glad you are here.

STATEMENT OF JOHN H. BARNARD, JR., VICE PRESIDENT, BECHTEL POWER CORP., SAN FRANCISCO, CALIF.

Mr. **Barnard**. Thank you very much, Mr. Chairman.

I am a vice president and director of Bechtel Power Corp. and a director of Bechtel, Inc., which are the principal operating companies of Bechtel headquartered in San Francisco.

I do appreciate this opportunity to offer a brief oral statement in support of the written testimony which we have already submitted, and I must also compliment the chairman and other members of the committee who have introduced legislation in this important area of correcting the problems that exist for the 1978 Foreign Earned Income Act.

The Middle East in particular is the largest constructon market in the world, and yet the participation of U.S. companies in it has steadily declined from a preeminent position in the early 1970's to 12th-ranking in 1979. With high U.S. unemployment and a widening trade deficit, it is critical that this Nation change its tax policies that inhibit the ability of U.S. companies to employ Americans overseas.

Although I am speaking today primarily from Bechtel's experience on this issue, I am also representing the views of Caterpillar Tractor Co., Dresser Industries, and Pullman Kellogg.

Most other industrialized countries of the world, as you know, do not tax the overseas earned income of their citizens. The United States does, and typically a U.S. engineer who is married with two children, and has a base annual salary of $33,000, costs $107,000 to maintain in Saudi Arabia. That is with an extended work week of 50 hours. A United Kingdom citizen in the same classification, under the same working situation, costs $67,000, or 37-percent less than the American.

As a result of such a great difference, Bechtel's U.S. expatriate population overseas has declined from 56 percent in September 1976, to 44 percent at the end of 1979.

In addition, U.S. technology in the petroleum and powerplant sectors is highly desired by developing countries, as is our managerial know-how. But the rapid rise in skill levels of competitive firms in Japan, Korea, and parts of Europe has resulted in the following situation:

We capture the management of multibillion-dollar projects, employing relatively few Americans in the work. I think Mr. Dickey's statement emphasized that point. But awards for the hands-on work for portions of the project go to other countries' contractors. They learn from us, and thus position themselves to bid for the "bread and butter" projects—$100 million to $300 million or $500 million size. These foreign contractors bid those projects in their own right.

Since 1978, Bechtel has bid many of these smaller projects in the Middle East and without success. The experience of other U.S. firms, I am sure, is somewhat similar. The consequences are not limited to a loss of construction work for American firms. Of significant importance is the opportunity lost of putting U.S. manufacturers' equipment into those projects and the follow-on business of spare parts, operating services, and so forth.

As skill levels of people in other exporting countries' construction industries rises, overseas clients are becoming more insistent that U.S contractors reduce the number of more expensive U.S. employees on their jobs. Pullman Kellogg's Algerian client in 1976 approved the use of American expatriates, but in late 1979, when 100 more were required, that client requested Pullman Kellogg to hire those additional people from the United Kingdom or Canada.

Similarly, Bechtel has had to limit the number of its U.S. personnel on a current project to 20 percent of the expatriate work force. So, opportunities are being lost to place American workers on these kinds of projects.

Due to increased oil activity in the world, U.S. petroleum equipment and service companies have increased their employees abroad. However, U.S. expatriates are losing out. The increases in the last 5 years for a large group of such companies has seen third company nationals increase 94 percent, local country nationals 89 percent, and U.S. expatriates only 37 percent, another example of how U.S. jobs are being lost in the world marketplace.

Consequences of this decrease in U.S. expatriates are felt in a "ripple effect" as well. That is, there is also the lost opportunity for exports, more equipment and services from the United States.

In conclusion, I strongly urge the committee to consider removing entirely the U.S. tax on income earned by Americans working abroad. Only with a change in the U.S. tax law will American engineering, construction, and industrial manufacturing and services firms become more competitive internationally.

Senator **Chafee**. Now, do you attribute this pulling back of the Americans in your London office and in the jobs abroad, the Algerian job and so forth, by Bechtel, primarily to the tax?

Mr. **Barnard**. I think it has a very real impact. I think the tax situation, from everything we see, is very definitely the reason why we are being requested to pull back Americans.

Senator **Chafee**. Well, in your testimony here, in your written testimony, you talk about seeking some engineers, and you advertised in Perth or Adelaide, Australia, and got a large quantity of capable people. You tried in the United States and did not succeed in getting Americans.

Is that due to the tax, something in our engineering courses, or the output we are having from our universities?

Mr. **Barnard**. I think that there is great reluctance among U.S. engineering people and others in the construction industry to take overseas assignments as long as there are jobs available in this country.

I think part of the problem with respect to their not volunteering to go overseas more readily also is the fact that individuals have a very difficult time understanding our tax law.

Senator **Chafee**. It is the very interpretation of it?

Mr. **Barnard**. Yes, it is complicated.

Senator **Chafee**. In other words, if they are going to Saudi Arabia or Algeria or someplace, they want to be paid extra for it?

Mr. **Barnard**. Yes, indeed. In order to make it attractive for any person to accept an overseas assignment in a country considered to be in a hardship area, having in addition, for example, an entirely different culture as well as a language difference, a monetary incentive must be offered. It is therefore not surprising that nationals from our foreign competitors are more eager to accept such an assignment when their take-home pay approaches that of their gross compensation.

Senator **Chafee**. And to do that is what costs your company the money?

Mr. **Barnard**. Yes, sir. For the reasons cited, there are substantial additional costs that must be compensated for whenever Bechtel seeks an employee for service overseas.

Senator **Chafee**. I see. Well, these are some pretty good illustrations. I think they would go beyond the anecdotal.

Mr. **Barnard**. Thank you very much, Senator.

Senator **Chafee**. We appreciate very much your coming.

Mr. **Barnard**. Thank you, Mr. Chairman.

[The prepared statement of Mr. Barnard follows:]

SUMMARY OF TESTIMONY OF JOHN R. BARNARD, JR.
ON TAX TREATMENT OF AMERICANS EMPLOYED ABROAD
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
SENATE FINANCE COMMITTEE

JUNE 26, 1980

1. The international marketplace is highly competitive, and it is vitally important that the 1978 Foreign Earned Income Act be substantially revised to help keep U. S. business competitive. With high U. S. unemployment, it is critical to this nation to change tax policies that inhibit the ability of U. S. companies operating abroad to employ Americans on overseas projects.

2. The Foreign Earned Income Act of 1978 should be judged by its impact on jobs — American jobs both abroad and here at home. Arbitrary adherence to issues of tax "parity," whether couched in terms of "equity" or "fairness," should not overshadow the real issues — those of jobs, exports and our balance of payments.

3. Experience of U. S. construction firms operating in the Middle East shows that even after the changes made by the '78 Act, U. S. tax laws still penalize companies that employ Americans abroad. Most other countries do not tax the overseas earned income of their citizens. The U. S. does. It is, therefore, not surprising that Bechtel experience since 1978 shows a decline in the number of Americans employed abroad, and a decline in the percentage of Americans hired for overseas locations as compared to nationals from other countries.

4. On foreign construction projects, principally with respect to cost-plus contracts, foreign private and government clients do not consider high U. S. taxes on Americans employed on such projects to be a legitimate cost. Such clients are increasingly insistent that any extra workers employed be nationals of other countries with low or no taxes on foreign earned income.

5. The declining competitiveness of Americans in overseas job markets adversely affects U. S. employment; adversely affects the ability of U. S. firms to obtain foreign contracts; lessens reliance on American technological standards and knowledge; and adversely impacts the U. S. balance of trade and payments and revenues.

TESTIMONY OF JOHN H. BARNARD, JR.
DIRECTOR, BECHTEL INCORPORATED
DIRECTOR AND VICE PRESIDENT, BECHTEL POWER CORPORATION
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
UNITED STATES SENATE

June 26, 1980

Mr. Chairman and Members of the Committee:

My name is John H. Barnard, Jr., and I am pleased to have this opportunity to appear before this distinguished Subcommittee. I am a Director of Bechtel Incorporated, and a Director and Vice President of Bechtel Power Corporation, international engineering and construction firms with headquarters in San Francisco. My responsibilities include general management of Bechtel's worldwide procurement, personnel, information systems and security organizations in support of its operating divisions. Today, I am also authorized to speak for Caterpillar Tractor Company, Dresser Industries, Inc., and Pullman-Kellogg, Division of Pullman, Inc. These four companies have formed an ad hoc working group to analyze the 1978 Foreign Earned Income Act and its impact on company operations.

A Congressional review of the 1978 Foreign Earned Income Act is now appropriate. The international marketplace is highly competitive, and we have concluded that the '78 Act must be substantially revised to help keep U.S. business competitive. In view of the deepening recession, with unemployment running near eight percent, it is of vital importance to this nation to change tax policies that inhibit the ability of U.S. companies operating abroad to employ Americans on overseas projects.

My basic arguments can be summarized as follows:

1. The Foreign Earned Income Act of 1978 should be judged by its impact on jobs -- American jobs both abroad and here at home. Arbitrary adherence to issues of tax "purity," whether couched in terms of "equity" or "fairness," should not overshadow the real issues -- those of jobs, exports and our balance of payments.

2. Experience of U.S. construction firms operating in the Middle East shows that even after the changes made by the '78 Act, U.S. tax laws still penalize companies that employ Americans abroad. Most other countries do not tax the overseas earned income of their citizens. The U.S. does. It is, therefore, not surprising that Bechtel experience since 1978 shows a decline in the number of Americans employed abroad, and a decline in the percentage of Americans hired for overseas locations as compared to nationals from other countries.

3. The declining competitiveness of Americans in overseas job markets adversely affects U.S. employment; adversely affects the ability of U.S. firms to obtain foreign contracts; lessens reliance on American technological standards and knowledge; and adversely impacts the U.S. balance of trade and payments and revenues.

I will develop these arguments by describing our experience in the international market since passage of the 1978 Foreign Earned Income Act.

Enactment of the Foreign Earned Income Act of 1978 significantly improved the tax treatment of U.S. citizens and residents working abroad over the drastic provisions of the 1976 Act. However, the '78 Act represented a compromise between oftimes conflicting considerations of tax equity and then current perceptions of U.S. trade and export policy. While a good step in the right direction, that Act turned out to be highly complex and costly to our employees. Moreover, it still inhibits employment of Americans abroad.

Costs of Employing Americans Abroad

Bechtel is involved currently in 118 major projects in 20 different countries around the world. The competition for such international engineering and construction projects is increasingly intense. There are many disadvantages imposed by U.S. law and practice on U.S. trade -- the lack of a clearly defined U.S. export policy, conflicting considerations in various boycott laws, problems in export-import practice, antitrust policy -- and not the least of which is the noncompetitive tax treatment afforded Americans employed overseas. This impacts adversely on each of the companies I am speaking for, but allow me to use the Bechtel example to show this tax impact.

Bechtel simply must keep its employee costs in line with competitors from other nations -- most of whom do not tax their nationals at all when working in certain foreign countries. But the company must daily deal with the fact that it costs substantially more to employ an American on one of its overseas projects than a qualified national from the U.K., Canada, Australia, etc. By substantially, I mean in the range of 35 percent or more.

I do not mean to infer that complete exclusion from taxation of income earned overseas would place a U.S. national's employment cost on a parity with the cost incurred in employing a national from another country. Complete parity cannot be achieved due to the higher compensation levels enjoyed by our citizens, our higher standard of living as compared to those of other countries, etc. But the elimination of U.S. tax on foreign income would significantly reduce the "cost" gap that presently exists between our nationals and those of other countries.

For example, under present law, to station the average married U.S. citizen with two school aged children in Saudi Arabia costs about $107,000 per year, whereas the costs associated with stationing a similar U.K. citizen are approximately $67,000. The American, therefore, costs over 1½ times as much as the citizen from the U.K. If complete income tax exclusion were adopted (similar to that allowed the U.K. citizen), the cost to maintain this U.S. family would decrease nearly 25 percent to about $80,000 per year. This $27,000 differential cost applicable to such an employee would become available as a direct reduction of cost passed on to our client, which could well become the difference as to whether a contract was obtained in the first instance.

Effect of Foreign Competition on Jobs for Americans

That additional tax cost in employing an American abroad is one part of what makes us less competitive internationally. We cannot ignore or hide that cost -- it is too large a difference. If we include that differential as a nonreimbursed cost, our profit margin goes down and at some point the project cannot be successfully bid, or even bid at all. In the alternative, if we try to pass that added cost along to the client, in many cases a foreign government or one of its agencies, we will probably be ordered to use fewer Americans in the mix of workers on that foreign project. Since many of our contracts are on a "cost-plus" basis, the clients are increasingly insistent that any extra workers employed be nationals of other countries with low or no taxes on foreign earned income.

For example, a major client of Pullman-Kellogg in Algeria, who in 1976 approved the use of American expatriates, has now instructed the company to employ one hundred U.K. nationals rather than Americans. The increased U.S. tax cost that has arisen since contract signing has been the subject of continual discussion with the client, resulting in the direct loss of employment for Americans. Further, on contracts in Saudi Arabia and Oman, after having been told by potential clients to minimize costs, Pullman-Kellogg has taken it upon itself to base its estimates using U.K. and Canadian employees who will have no home country tax costs. Again, potential American jobs are lost.

Furthermore, due to this cost difference, one client recently required Bechtel to limit the number of U.S. personnel to 20 percent of the expatriate work force. Normally 50 to 60 percent of the available jobs would have been filled with Americans. In this instance, the differential was filled by U.K. nationals.

In earlier Congressional testimony on Section 911 -- from 1975-1978 -- various witnesses pointed out that, because of the added tax costs, Americans would return home, either voluntarily or involuntarily, and that the positions formerly held by such returnees, as well as new overseas jobs, would be filled by nationals from other countries. These earlier predictions have been borne out by recent experience.

Recruitment of Americans for Overseas Work

Recruiting of U.S. personnel for overseas positions has become extremely difficult. The converse has been true in the case of personnel from other countries.

As an example, just recently Bechtel placed an ad in a Perth, Australia newspaper for technical services personnel to work in Saudi Arabia. This resulted in receipt of 40 applicants, 30 percent of which (12) were considered to be good candidates. This response far surpassed the results we can obtain in the U.S., where our experience during 1979, for example, produced only a 4 percent return of good candidates.

One basic reason for this difference has been that no monetary incentive for overseas service in low tax countries exists for our U.S. nationals under our current tax policies. This differs from the other major industrialized countries of the world which have no tax on the earned income of its citizens employed in other countries. It should not be surprising that persons from foreign countries are eager to accept an assignment in a low or no tax host country (even one having a different culture and language from that of their home country) when their net take-home pay approaches that of their gross compensation.

Current Reduction of Americans Abroad

Some have said that overall employment of Americans abroad is on the increase. That is not the Bechtel experience. Since passage of the Foreign Earned Income Act of 1978, the absolute number of Americans employed abroad by Bechtel, and the relative percentage of Americans to other nationals, has decreased. In September of 1976, immediately prior to enactment of the TRA of 1976, 56 percent of Bechtel employees abroad were U.S. nationals. This percentage declined to 48 percent in mid-1978, and at the end of 1979, stood at a little under 45 percent. At the end of 1979, we had slightly less than 85 percent of the U.S. nationals overseas that we had in September of 1976. As another illustration, in the Bechtel office in London, approximately 6 to 8 percent of the employees are U.S. nationals, whereas the norm in prior years had been between 20 to 30 percent. Furthermore, in the case of personnel at the job site, 20 to 25 percent are now U.S. nationals, whereas we normally like to have 35 to 40 percent.

Pullman-Kellogg has had an increase in Americans employed abroad, due to previously planned staffing on a contract awarded in 1976. In 1977 about 19 percent of all expatriates on Pullman-Kellogg jobs were from other than the U.S. In 1979, nationals from other countries were 26 percent of the work force. It is estimated that unless U.S. tax costs fall, 50 percent of Pullman-Kellogg expatriates will be from other countries by the end of 1981, and 62 percent by the end of 1982. The number of Americans working abroad for Pullman-Kellogg will peak in 1980, declining each year after that, while the number of other nationals rises.

The critical question, therefore, is not only whether our expatriate population is increasing, but whether the percentage of Americans employed abroad is being significantly increased.

International Trade and Competitiveness

From our experience, it appears clear that the level of U.S. tax on Americans employed abroad has a definite impact on the overseas operations of U.S. engineering and construction firms and firms supplying equipment and services associated with overseas projects. The U.S. firm is no longer "invincible" in the world marketplace. It is still true that U.S. expertise in the engineering and construction industry is highly prized, especially in developing areas of the world such as the Middle East. In like manner, U.S. technology in the petroleum sector and other services has always been considered preeminent. However, foreign clients are no longer willing to pay a high premium for that "uniquely" American expertise. That American "flavor" can now be obtained with fewer Americans than ever before. Either our clients specify fewer Americans, or we are forced to employ fewer Americans in order to stay competitive with the companies headquartered in countries such as France, the U.K., West Germany, Italy, South Korea and Japan. Simply put, in a cost-plus contract, foreign private and government clients do not consider high U.S. taxes on Americans employed on that project to be an acceptable cost. On a non-cost-plus contract, companies must factor into any project bid the high compensation necessary to keep U.S. workers on that proposed project. Such compensation must, of course, reflect the U.S. tax consequences that will result, by accepting employment overseas.

The impact of these considerations has been dramatic. As stated in the November 29, 1979 issue of "Engineering News-Record,"

> The U.S. construction industry, once the most competitive force in the international arena, has seen its edge dulled in recent years by a debilitating paper storm of federal regulations, tax policies and export restrictions. At the same time, governments and contractors in Europe, Japan and elsewhere have sharpened their attack in the third world. Nowhere are the results of this shift more apparent than in the Middle East, the largest export market on earth, where Americans now rank 12th in the race for new construction business.

There is a dramatic "pull" effect on goods and services -- and therefore jobs -- from the United States on construction projects in foreign locations. The "ripple" or "feedback" effect is highly important. For example, in a typical foreign construction project in a developing country, about 50 percent of the non-manual job hours is expended "on site," and the rest is expended in permanent offices in the U.S. or elsewhere. If, due to the higher tax costs on Americans overseas, American business is not competitive and the bid is lost, an enormous amount of support work in the U.S. is never done. Supplies of goods never leave our shores; work and jobs directly related to those goods are lost; tax revenues on that work never reach the U.S. Treasury. There is, in short, a tie-in between American jobs abroad and our domestic employment picture.

Let me further pinpoint a couple of our key problems in this area. The developing countries still highly value American technology and managerial know-how for the individual programs costing billions of dollars (mega-projects). This may continue throughout the decade of the 80's. However, there are many firms in Europe, Japan, and Korea which can now perform well at reduced cost on the jobs in the $100 million to, say, $300 million range. It is principally in this "bread and butter" area of project size -- $100 to $300 million -- that we are losing out because of the cost of keeping Americans overseas. If this trend continues, the upper limit to that range will keep on rising as contractors from other countries gain additional experience.

We find ourselves in the position of training engineers and supervisors from other countries who are serving as contractors on Bechtel's mega-projects. With the skills thus obtained, they in turn are bidding, in competition with us, to do work as prime contractors on the "smaller" jobs, thus depriving the U.S. of a chance to supply plant and equipment, initially and for future expansion, follow-on spare parts, etc., which would be so positive to our balance of payments and reduction of U.S. unemployment rates. This is what we speak of as the "ripple" effect of employing American engineers overseas.

When Americans are involved on a project from start to finish, there is a natural tendency for them to use U.S. goods and services with which they are more familiar. An American consultant brought in when a project is in the initial concept stage is more likely than a European or Japanese consultant to think in terms of U.S. products, ranging from electrical equipment to hospital beds.

Further, there is great value to the long-term competitiveness of this country's export sector in having Americans serving abroad in sales, financing, training, and services and other product support functions. Personal contact with day-to-day challenges of selling and using U.S. made products in a wide range of situations around the world helps keep American individuals and companies alert to changing needs, and aware of what our competitors are doing. Finding a better way to meet today's challenges contributes to more competitive products and methods tomorrow. Our tax laws, unfortunately, penalize through higher costs those who seek to provide international business experience for their American employees.

Conclusion

I would strongly urge this Committee to consider removing entirely U.S. tax on income earned by Americans employed abroad. Of course, there should be provisions or limitations to prevent the "abuse" case. This hearing is focused on a number of bills that either remove taxation entirely or provide a significant exemption. We think first priority should be given to bills that would remove taxation on overseas income. There are other alternatives. If the general exclusion approach is followed, we would urge as large a general exclusion as possible with, additionally, a more appropriate housing deduction than that under present law. Since it seems difficult and time consuming to be continually "revisiting" those code provisions, you may wish to consider "indexing" these amounts.

Only with such changes in U.S. tax law will American construction, engineering and supply firms become more competitive in the international marketplace, with the resulting benefits, both directly and indirectly, going to U.S. citizens, business, and local, state and the national government as well.

Thank you for the opportunity to testify on this important issue. I would be happy to answer any questions the Committee may have.

Senator **Chafee**. Now we will have a panel of Mr. Culpepper, the president of the U.S. and Overseas Tax Fairness Committee, Mr. Shriner from Chase Econometrics, and Larry Fisher, from Fluor.

STATEMENT OF FRED C. CULPEPPER, JR., PRESIDENT, U.S. AND OVERSEAS TAX FAIRNESS COMMITTEE, INC.

Mr. **Culpepper**. Mr. Chairman, my name is Fred Culpepper.

Senator **Chafee**. Now, how are you going to divide this up? Are you going to stay within some time limitation?

Mr. **Culpepper**. I will try very hard to do so.

Senator **Chafee**. I would say a total of 15 minutes for the panel. We will have to stick to that limit. All right, go to it.

Mr. **Culpepper**. I am president of the U.S. and Overseas Tax Fairness Committee. The committee represents over 60 of the Nation's largest manufacturing and engineering and construction firms with extensive commitments in overseas markets. I am also here on behalf of the members of the National Constructors Association and the American Consulting Engineers' Council.

In addition, I am representing George Fisher and the American Constituency Overseas. ACO represents many American working men overseas whose jobs are threatened under current tax law.

Mr. Fisher has presented a statement for the record. I encourage you to give special attention to that statement.

With me today are Mr. Larry Fisher of Fluor Constructors and Dr. Robert Shriner of Chase Econometrics. Mr. Fisher will present a case history of what is at stake in an actual $2 billion overseas contract for which his firm has been in competition. Dr. Shriner will present the findings of a study of the impact which the current U.S. practice of taxing foreign-earned income has on U.S. trade flow and on U.S. business and U.S. tax revenue.

As you know, the issue we are looking at today, the question of how Americans working overseas should be treated for tax purposes by the U.S. Government has been the subject of intense debate for the past 4 years. The debate was touched off by the 1976 changes in the tax treatment of Americans working overseas.

When combined with two Tax Court rulings that year, they produced negative results no one foresaw. Fortunately, Congress quickly realized that the 1976 changes would strangle American business activities overseas. It agreed to postpone the effects of those changes until a new approach could be worked out. Even so, the uncertainty set in motion in 1976 has finally damaged our overseas business activities.

As you know, a compromise measure now known as the Foreign Earned Income Act of 1978 was passed late that year. At the time, we all thought we could live with it, that we could make it work. Unfortunately, we were wrong. The remaining tax burden on Americans was simply too great, especially when compared to our competitors in the international marketplace.

In some cases, in fact, Americans working overseas were actually worse off than they were under the 1976 code. Furthermore, the 1978 provisions led to extraordinarily complex regulations. Those provisions tended to be very restrictive and almost impossible for American businesses overseas to interpret or administer.

During all of this, the debate has continued. The basic arguments have not changed. I am suggesting to you that of all the trade disincentives currently in operation, none can be reversed as readily or produce more immediate positive results than the current U.S. practice of taxing the income earned by Americans abroad.

Action this year, within the next few months, can effectively slow the momentum towards further trade flow deficits and get the flow headed in the other direction. If we do not get action in the next few months, we will likely be meeting about this time next year many more billions of dollars in the hole and with a needless toll in additional U.S. unemployment, as Dr. Shriner will show.

We are presenting a great deal of new data to support action now. They prove beyond doubt the direct connection between our presence abroad and our exports. But the data simply document what anyone with experience in foreign markets already knows as a matter of experience and just plain commonsense.

If you want people to buy your goods and services, you have got to have a significant presence in the marketplace, and you have got to be competitive. Trade, after all, is a highly social process, and depends on our on-the-scene knowledge of the marketplace, our contacts, our visibility, and our credibility.

In today's international economy, a system our Nation substantially created, we cannot maintain our place in the market by reducing our presence, yet after all the data and studies and case histories are assessed today and in the days following these hearings, it will be obvious that we have been trying to do exactly that in recent years, and have dropped from over 23 percent of the worldwide market share to less than 14 percent in a decade largely as a consequence.

The engineering and construction industry has been particularly hard hit, dropping in worldwide share of the construction volume from 1st place 4 years ago to 7th place currently, and from 1st to 12th place, or from 10 percent of the total to less than 1.5 in the rapidly expanding Middle East market.

I know that some sources continue to dispute the evidence that higher U.S. taxes are forcing Americans to abandon overseas markets and return home. It has happened in some areas at rates in excess of 50 percent. In truth, given the rapidly expanding overseas market, our presence overseas should be expanding, not shrinking.

I would like to make the point that this country's trade policies must also take into account the many nontrade benefits of an American presence overseas, benefits that are or should be obvious. It takes little imagination to realize the potential damage to our future influence in the Middle East that stems from the fact that due almost entirely to U.S. tax policies, the percentage of Americans on the faculty at the University of Petroleum and Minerals in Dhahran, Saudi Arabia, has dropped from 89 percent in the early seventies to less than 15 percent today.

Senator **Chafee**. I think that is a very, very important point, and as I say, you can't quantify this. From this overseas presence comes a host of people who have learned the foreign language, whose children are familiar with the indigenous customs, who can come back and later go overseas in various capacities, in the Foreign Service or whatever. It is good for the United States, and I think that is a side issue that should not be discounted in the potential loss that results from this bill.

It isn't just in jobs, but it is in the long-term influence of this Nation around the world. I am glad you brought that up and particularly that illustration. Now, you attribute the decline in the jobs in Dhahran at the petroleum institute there to the tax policy?

Mr. CULPEPPER. We certainly think so.

Senator CHAFEE. Do you have any evidence? Have they interviewed these people, the professors?

Mr. CULPEPPER. Not all of them, no.

Senator CHAFEE. No, but I mean——

Mr. CULPEPPER. Individually, some, and there have been indications that the tax laws have indicated the way they would go.

Senator CHAFEE. Fine. Thank you.

Mr. CULPEPPER. The point, of course, here, is that there were many of the future leaders in the Middle East training at this university. Think what that shift will cost our Nation, its vital interest, influence, and security in the years. This must be stopped.

Our current tax practices wholly ignore the value to the United States in the international marketplace of American dedication, drive, energy, and resourcefulness. Things we take for granted here at home and that are built into our culture and work ethic, but anyone with experience knows that they give us a substantial advantage in overseas markets and enormous appeal, if we can afford to keep Americans in the international marketplace, and that, of course, goes to the issue.

Americans must have incentives to work overseas. They must at least be in the same tax footing as citizens from competing industrial nations. We are showing today that the incentives we will need cost the Government nothing, but it will net the Government billions of dollars in added real tax revenues.

I thank you for your interest, and I hope with your help we will start to reverse the tendency to penalize Americans working overseas and start acknowledging their real contribution to the economics and well-being of our country.

Senator CHAFEE. Fine. Thank you, Mr. Culpepper.

Mr. Shriner, are you next?

[The report prepared by Chase Econometrics follows:]

ECONOMIC IMPACT OF
CHANGING TAXATION
OF U.S. WORKERS OVERSEAS

Prepared By:

CHASE ECONOMETRIC ASSOCIATES, INC.

900 17th Street, N.W.
Washington, D.C. 20006

Prepared For:

U.S. and Overseas Tax Fairness Committee

June 1980

TABLE OF CONTENTS

PAGE

I. EXECUTIVE SUMMARY 1

II. BACKGROUND OF THE STUDY 4

III. IMPACT OF THE TAX ON INDIVIDUALS. 11

IV. IMPACT OF TAX ON FIRMS. 24

V. IMPACT OF TAX CHANGE ON THE U.S. TREASURY . . .30

APPENDIX A: SURVEY OF U.S. FIRMS WITH OVERSEAS OPERATIONS

APPENDIX B: COMPUTATION OF TAX OBLIGATIONS IN ILLUSTRATIVE CASES

I. EXECUTIVE SUMMARY

1. OBJECTIVE AND APPROACH OF THE STUDY

Chase Econometrics was commissioned by the U.S. and Overseas Tax Fairness Committee to conduct an independent appraisal of the impact of recent changes in the U.S. tax code imposing additional taxes on U.S. workers overseas. This report covers the results of the first phase of that effort. Subsequent phases will address specific issues identified during this initial phase.

In this initial phase, Chase Econometrics gathered and reviewed prior studies on this topic prepared by both private organizations and government agencies, and some of the data used here are derived from these prior studies. In addition, to provide up-to-date information on the impact of the tax changes upon business firms and individuals, survey questionnaires were sent to large U.S. construction and engineering firms, to personnel recruiters, and to business firms with U.S. marketing and manufacturing personnel overseas. Finally, the Chase Econometrics U.S. Macroeconomic Model was used to estimate the impact on U.S. tax receipts, employment, and other economic factors due to a reduction in U.S. exports associated with increased taxes on U.S. workers overseas.

2. PRINCIPAL FINDINGS

The results of our survey and analysis strongly indicate that recent revisions in taxation of U.S. workers abroad have an adverse effect on exports. This causes a reduction in overall tax receipts far greater than the taxes paid by overseas workers. Moreover, the loss of export markets is principally in areas where markets are expanding and where the loss in market share will be felt long into the future.

Among the principal findings are the following:

- The impact of the tax varies greatly from country to country, raising serious problems of equity.
- The after-tax income of U.S. workers overseas is substantially reduced, unless employers provide equalization. For construction workers, the loss averages $3600; for other workers the loss averages about $7800.
- A high percentage of U.S. workers abroad -- in some cases as high as 50% or more -- are voluntarily and involuntarily returning to the U.S. because of the tax.
- The return of American workers from overseas increases the domestic work force but does not increase the number of domestic jobs. Therefore, domestic unemployment increases.
- The cost of maintaining U.S. workers overseas has risen substantially due to the tax. Survey results indicate that these costs add 2 to 10 percent to the cost of U.S. goods and services, depending on the industry involved.
- The increased cost of employing U.S. workers overseas and the reduction in the number of U.S. workers overseas reduces the competitiveness of U.S. goods and services abroad and results in a significant drop in exports.
- Survey results and other analyses indicate that the overall drop in real U.S. exports amounts to about 5 percent.
- The drop in U.S. income due to a 5 percent drop in real exports will raise domestic unemployment by 80,000 and reduce federal receipts from personal and corporate income taxes by more than $6 billion in 1980, many times the value of tax expenditures under Section 911 and 913.

- Reduced domestic income from lost exports cuts state and local corporate profits taxes by $700 million and state and local personal tax receipts by $100 million. Unemployment compensation payments increase by some $200 million, more than the total additional federal taxes paid by overseas workers.

- Treasury estimates of tax expenditures from Section 911 and 913 overstate the potential gain in revenue since they ignore the drop in corporate profit taxes when employers equalize the pay of overseas workers and they ignore the effect of workers returning to the U.S. to avoid the extra burden of the tax.

- The impact on U.S. export competitiveness is greatest in emerging market countries where such high-value-added U.S. exports as construction and engineering are reduced along with the substantial volume of merchandise exports generated by major projects.

The overwhelming conclusion from these findings is that the negative impacts of the change in taxes on U.S. workers -- on overall tax receipts, on exports, on domestic unemployment, and on other social and economic factors -- are many times greater than the projected gain in personal taxes paid by overseas Americans.

3. ORGANIZATION OF THIS REPORT

This report examines the impact of recent changes in taxation of overseas Americans on individuals, firms, and the U.S. economy. Chapter II describes recent changes in the tax structure and examines relevant prior work. Chapter III discusses the impact of the tax change on individuals; Chapter IV discusses the impact on firms; and Chapter V discusses the implications of these impacts for Treasury revenues.

II. BACKGROUND OF THE STUDY

Substantial changes have been made since 1975 in the sections of the Internal Revenue Code which regulate the taxation of American citizens working in the private sector abroad. This chapter discusses the recent history of these tax revisions and prior studies of this topic, including:

- Pre-1976 law and practice
- 1976 Tax Court decisions
- 1976 tax law revisions
- 1978 tax law revisions
- Revisions currently pending in Congressional committees
- Prior studies and their focus

1. PRE-1976 LAW AND PRACTICE

Section 911 of the Internal Revenue Code contains the regulations concerning the partial exclusion from U.S. income tax of foreign earnings of U.S. workers employed abroad. Foreign income exclusion has been a part of the tax code since 1926, although over the years the magnitude and coverage of the exemption has decreased.

In 1975, Americans working in the private sector abroad were allowed to exclude $20,000 of earned income a year if they met the minimum residency requirements of presence in a foreign country for 17 out of 18 consecutive months or were considered a bona fide resident of the foreign country, having lived there for at least a full taxable year. The exclusion increased to $25,000 if the taxpayer resided in a foreign country for three consecutive years. Other provisions of the pre-1976 law were that:

- Excluded income came "off the top" (i.e., excluded income was subtracted from gross income, reducing taxable adjusted gross income) so that remaining income fell into a lower marginal tax bracket.
- Foreign taxes paid on excluded income could be credited against U.S. tax due on included income.
- Individuals could claim either the standard deduction or the foreign tax credit, but not both.

2. 1976 TAX COURT DECISION

Two 1976 rulings of the Tax Court (Philip H. Stephens, T.C. Memo 1976-13, and James H. McDonald, 66 T.C. 223 (1976)) greatly increased the tax on overseas workers through interpretation of Section 119, concerned with taxation of housing, travel, and education allowances. The Tax Court interpreted Section 119 narrowly, judging that certain allowances and expenses paid by an employer on behalf of an employee were taxable unless the lodging and meals furnished by an employer were:

- for the convenience of the employer;
- on the employer's business premises
- required to be accepted by the employee as a condition of his employment.

Before the ruling, many taxpayers interpreted Section 119 as excluding from U.S. tax most allowances and expenses provided by the employer although the allowances were not expressly for the convenience of the employer. The Tax Court rulings also stipulated that the full market value of housing provided by an employer to an employee in the foreign country, not the estimated U.S. cost of comparable housing, was considered taxable income to the employee.

3. 1976 TAX REVISION

The Tax Reform Act of 1976 made substantial revisions to Section 911 of the Tax Code. Its key provisions:

- reduced the income exclusion to $15,000. ($20,000 for employees of charitable organizations).
- required that excluded income would be taken "off the bottom" (i.e., excluded income would not be subtracted from gross income to determine taxable adjusted gross income), which shifted taxpayers into higher marginal brackets.
- disallowed foreign tax credit on foreign tax attributable to the excluded $15,000.

These provisions were never implemented. They were delayed by the Tax Reduction and Simplification Act of 1977 and partially replaced by the Foreign Earned Income Act of 1978, discussed further in the next section.

4. 1978 REVISIONS

In 1978, Congress again revised the law regarding taxation of Americans working abroad. The Foreign Earned Income Act of 1978, which is currently in effect, allows deductions for some specific living expenses but limits the flat income exclusion to people living in hardship camps in remote areas. The new law altered Section 911 of the tax code and added Section 913.

The important provisions of Section 911 under the new law were the following:

- Income exclusion was raised from $15,000 to $20,000 but was limited to residents of hardship camps in remote areas.

- The foreign tax credit on excluded income was disallowed.

- Residency requirements remained the same as in the 1976 Act.

Section 913 was added to the tax code to cover Americans working abroad who did not reside in camps and consequently were ineligible for the Section 911 income exclusion. It allows the following deductions for expenses of living abroad:

- A cost of living differential determined under IRS tables which accounts for the different costs of living in various countries for families of different sizes. The differential is based on the spendable income of a person at the GS-14 level and is determined with reference to the highest cost metropolitan area in the Continental United States.

- Most education expenses for the education of taxpayer's dependents at the least expensive adequate school within a reasonable commuting distance from the residence.

- Housing expenses above a base housing amount. The base housing amount is 20% of the difference between the individual's earned income and the sum of housing expenses, cost of living differential, qualified education expenses and qualified home leave travel expenses. However, if the individual maintains a separate household for his spouse and dependents because of dangerous or unhealthful living conditions or employer requirements, a deduction is allowed for the full cost of the taxpayer's housing.

- Home leave expenses. Reasonable cost of one round trip annually for taxpayer and dependents to the last residence within the continental U.S. are deductible.
- Living in a hardship area. A deduction of $5,000 is allowed for individuals living in those areas which qualify for second-tier (15 percent) hardship post differentials for U.S. government employees.

U.S. workers living in camps can elect to take either the Section 911 income exclusion or the Section 913 excess cost of living deductions.

The 1978 law also changed the rules on the deduction of moving expenses under Section 205 of the Tax Code. Costs attributable to temporary living expenses were increased to cover 90 days and the ceiling on costs was raised to $4,500. Moving expenses back to the U.S. were made deductible for American retirees and families of American workers who died abroad within the year. The strict interpretation of these provisions by IRS in setting regulations minimized any beneficial effect they might have had for U.S. overseas workers.

4. PROPOSED REVISIONS

A number of proposals have been made to alter Sections 911 and 913 of the IRS code. Several of these bills are currently pending in Congressional committees. The proposals range from tax exemption for all foreign source income of U.S. workers abroad to a return to the pre-1976 provisions (that is an off-the-top income exclusion instead of Section 913 deductions). There is also a proposal to change the residency requirement to 11 out of 12 months instead of 17 out of 18 months.

5. PRIOR STUDIES AND THEIR FOCUS

In preparing the present study, we have reviewed the recent major studies on the impact of changes in the tax provisions regarding income of American workers living overseas. Where appropriate, we have used data or conclusions from those studies in preparing our own analysis. Each of these studies is briefly highlighted below:

General Accounting Office, Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas: A Report to Congress. February 21, 1978.

This report presents conclusions about the effect of tax changes on Americans working abroad using two types of analysis. The first section reports conclusions based on a survey of Americans working in foreign countries as well as U.S. firms employing Americans abroad. The second portion reports estimates calculated using Data Resources' model on the effect of tax changes on U.S. balance of payments, domestic employment, G.N.P. and the federal budget level.

Gravelle, Jane G., and Kiefer, Donald W. U.S. Taxation of Citizens Working in Other Countries: An Economic Analysis. Congressional Research Service Report 78-91E. April 10, 1978. 75 pp.

The purpose of this study is to evaluate alternate tax proposals according to the principles of tax neutrality, tax equity and the achievement of national economic goals. It proposes the taxation of "excess" cost of living compensation at the same rate as income without the compensation. Tables showing the amounts and effective rates of various tax alternatives in various foreign cities are included.

Department of the Treasury, Taxation of Americans Working Overseas: Revenue Aspects of Recent Legislative Changes and Proposals. February 1978.

This report analyzes the changes in tax liability of Americans working abroad which resulted from the 1976 Tax Reform Act and which would result from S. 2115. Detailed data are presented which show the revenue impact of the various tax alternatives in total, and by region or country.

Mutti, John The American Presence Abroad and U.S. Exports. Office of Tax Analysis Paper No. 33, U.S. Treasury Dept., Oct. 1978.

The author uses a regression model and cross-sectional data for the year 1974 to examine the impact of the presence of Americans overseas on U.S. exports. Principal findings were: (1) Americans overseas make a significant contribution to U.S. exports. A decline of 10 percent in the number of Americans abroad would result in a decline of 5 percent in the value of U.S. exports. (2) A tax increase would affect the number of Americans working abroad; elimination of the current protection provided by Section 911 would result in a reduction of U.S. manufactured exports estimated to be on the order of three percent.

U.S. Office of Management and Budget. Equitable Tax Treatment of United States Citizens Living Abroad, Jan. 24, 1980.

This report examines U.S. tax treatment of U.S. workers overseas as compared with the policies of Canada, France, Germany, Japan, and the United Kingdom. The limited information on the characteristics of overseas Americans is discussed, and the arguments for and against changing the tax system are evaluated.

III. IMPACT OF THE TAX ON INDIVIDUALS

This chapter discusses the impact of the tax change on individuals. The framework for analysis is the idea that the willingness of Americans to work overseas is related to after-tax income.

An individual makes the decision to work overseas if he perceives that his overall situation will be as good or better than in the U.S. and he will remain overseas as long as this continues to be the case. Even before the recent changes in the U.S. tax laws, some Americans working abroad received equalization payments to cover foreign taxes.

This chapter will examine the importance of the tax system in location decisions of American workers, the distribution of the tax burden across individuals, and the evidence on the return of Americans from overseas posts.

1. IMPACT OF THE TAX SYSTEM ON LOCATION DECISIONS AND THE NUMBER OF AMERICAN WORKERS OVERSEAS

A change in after-tax income of American workers employed overseas causes a change in the supply of Americans willing to work overseas. When taxes on overseas workers are increased, some will find that it is no longer worthwhile to work overseas. On the other hand, if taxes on overseas workers are decreased, some workers will find overseas employment more attractive than before.

The demand for American workers overseas will also be affected by tax changes. The demand for American workers overseas depends on the cost of employing American workers relative to workers from other countries, the skill levels of Americans relative to others, and the firm's overall need for workers. To the degree that tax changes increase the relative cost of employing Americans, the demand for Americans abroad will decline.

Thus, tax increases on U.S. workers overseas lead to a decline in their after-tax incomes, and result in the return of some Americans from overseas. In addition, tax increases raise the cost of maintaining U.S. workers abroad and result in the involuntary return of Americans due to reduced demand for their services.

These changes then have an impact on domestic workers. The return of American workers from overseas increases the domestic labor force but does not increase the number of domestic jobs. Therefore, domestic unemployment increases.

2. DISTRIBUTION OF TAX BURDEN

It is always difficult to make the burden of taxation equitable. It is all the more difficult when trying to create equity among U.S. citizens living in vastly different countries, with different local taxes and living conditions. The tax burden is unevenly distributed among Americans overseas as it is among Americans in the U.S. However, recent changes in Section 911 pose new inequities rather than reducing old inequities. The magnitude of the change in after tax income due to recent changes in the tax code depends on the following factors which differ greatly among countries:

- The level of income taxation in the foreign country. Foreign income taxes are creditable against U.S. income taxes. For some Americans in high-tax countries, the increased U.S. taxes are wiped out by the foreign tax credit. The greatest burden will fall on Americans in low-tax countries who will pay the full amount of the tax increase.

- The level of allowances received by the employee. Americans who received substantially less than $20,000 in allowances are very hard hit by the 1978 legislation replacing the flat exclusion with specific deductions. Another vulnerable group is workers in high-cost countries whose allowances are not fully deductible.

- The degree to which employers agree to compensate employees for increased tax. Even before the tax changes, many Americans overseas paid higher taxes overseas than they would have paid on the same salary in the U.S. Moreover, foreign taxes which are not based on income (such as value-added taxes) are not creditable against U.S. income tax. To maintain U.S. workers in foreign assignments, employers often provide special compensation to offset these added costs to their workers; but the practice is not uniform.

- Other income sources. Individuals who have income from sources other than employment (such as dividends and interest) find that the tax on allowances pushes them into a higher bracket and subjects that income to taxation at much higher rates.

Thus, the impact of recent tax changes is predictably concentrated among Americans in low-tax countries who have either very low or very high levels of allowances and whose employers do not compensate them for the increased taxes. This raises serious problems of equity among U.S. workers in different parts of the world.

Beyond this general analysis, very little evidence is available on the characteristics of U.S. workers overseas which would aid in pinpointing the areas of greatest impact. Our study finds that no estimates have been made of the distribution of impact of the current legislation. Exhibit 1 presents the distribution of the tax increases which would have resulted from the implementation of the 1976 Reform Act. This analysis, prepared from Treasury data, indicates an increase of $1,000 or more per tax return for all areas except Oceania and Canada and an increase

EXHIBIT 1

DISTRIBUTION OF INCREASED TAXES* BY REGION

REGION	TAX INCREASE (Million)	PERCENT INCREASE	NUMBER OF RETURNS	INCREASE PER RETURN
OPEC Countries	$71.5	118%	15,534	$4,604
Japan	16.8	139	5,251	3,200
Latin America	47.0	125	17,953	2,619
Western Europe	117.3	130	45,702	2,567
Asia	36.8	161	18,442	1,993
Other Mid-East, Africa	12.1	162	11,348	1,069
Oceania	8.4	146	9,727	860
Canada	3.5	37	20,683	169
All Other Countries	4.6	90	4,606	1,000

*Difference between 1975 law (as interpreted by the Tax Court) and 1976 Reform Act. Figures calculated from Department of Treasury Report, Taxation of Americans Working Overseas, February 1978.

of at least 90% for all areas except Canada. The largest dollar increase of $4,604 per return occurs in the Middle Estern and African OPEC countries.

3. WIDE VARIATION IN IMPACT ON INDIVIDUAL WORKERS

In order to examine more closely the impact of the computed tax on individuals, we computed tax obligations for four illustrative cases that indicate the great variability of the impact of the current legislation:

- a U.S. marketing representative in Japan
- a U.S. employee of a charitable organization in Mexico
- a U.S. engineer in Saudi Arabia
- a U.S. financial manager in Hong Kong

These cases were chosen to show the impact of the tax at different levels of income and allowances and different types of countries. A mixture of high tax and low tax, developed and developing countries was chosen. Except for the charitable worker in Mexico, all individuals are assumed to have a base salary of $40,000 and to have comparable accomodations; but their tax burdens vary widely.

Exhibits 2 through 5 show the tax situations of the workers under the 1975 practice, 1976 law (including the impact of the Tax Court decision) and the current legislation.[1] The key features of each case are highlighted below:

---

[1] Appendix B contains the tax computations and information on methods.

- **Employee of charitable organization in Mexico** (Exhibit 2).

A U.S. worker in Mexico with a $20,000 income will experience no change in U.S. taxes as a result of the tax changes; but he will pay higher taxes than his counterparts in the U.S. Because Mexico levies higher income taxes than the U.S., the impact of the increase in U.S. taxes is offset by foreign income tax credits. In all cases, however, the total income tax burden (U.S. and foreign) on the employee is substantially greater than it would be on a worker in the U.S.

- **Engineer in Saudi Arabia** (Exhibit 3).

Saudi Arabia is a low-tax, developing country whose population of American workers was growing before the tax change. Americans in Saudi Arabia face extremely high housing costs. We asumed a $30,420 annual housing allowance, which is quite low in the light of rent and maintenance costs. The cost of American-style education for two children is over $10,000 per year. Saudi Arabia has no personal income tax against which to offset U.S. taxes. Before the Tax Court decision, the engineer paid $18,562 in U.S. taxes. After the Tax Court decision, the housing allowance was included as income, and taxes increased by 90 percent to $35,293. Current law results in an increase in taxes of $1,005 over the pre-1976 level.

- **Marketing representative in Japan** (Exhibit 4).

Japan is a high-tax, developed country with extremely high housing costs and high overall cost of living. Total allowances for the marketing rep total more than the base salary. Under 1975 practice, the marketing rep paid $24,765 in foreign tax and no U.S.

EXHIBIT 2

TAXATION OF U.S. CHARTABLE WORKER IN MEXICO
$20,000 SALARY

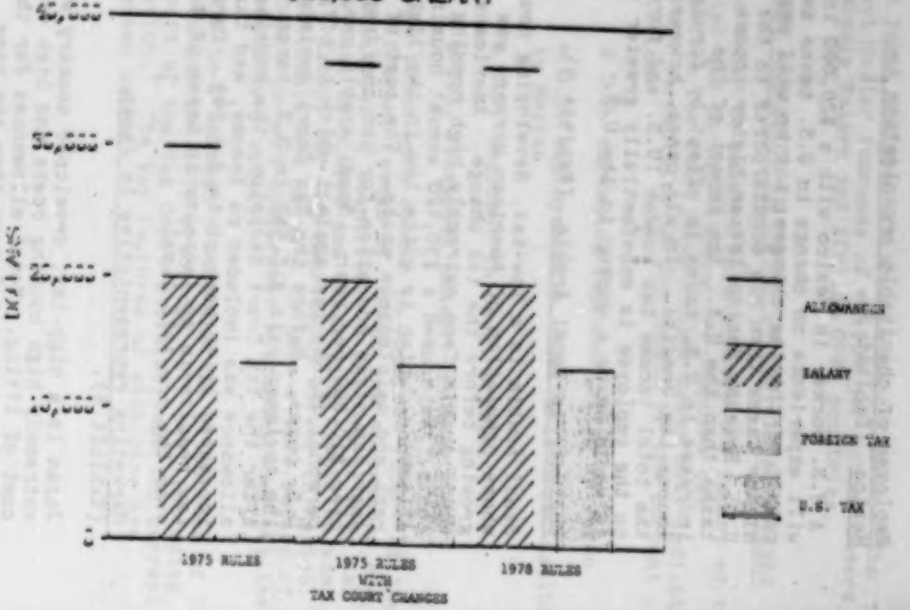


EXHIBIT 3

TAXATION OF U.S. ENGINEER IN SAUDI ARABIA
$40,000 SALARY

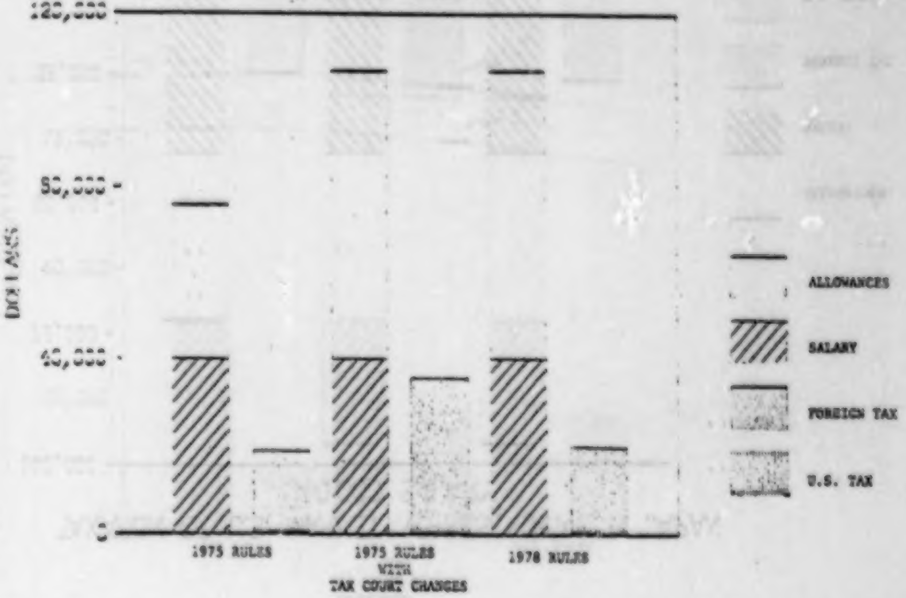


EXHIBIT 4

TAXATION OF U.S. MARKET REPRESENTATIVE IN JAPAN
$40,000 SALARY

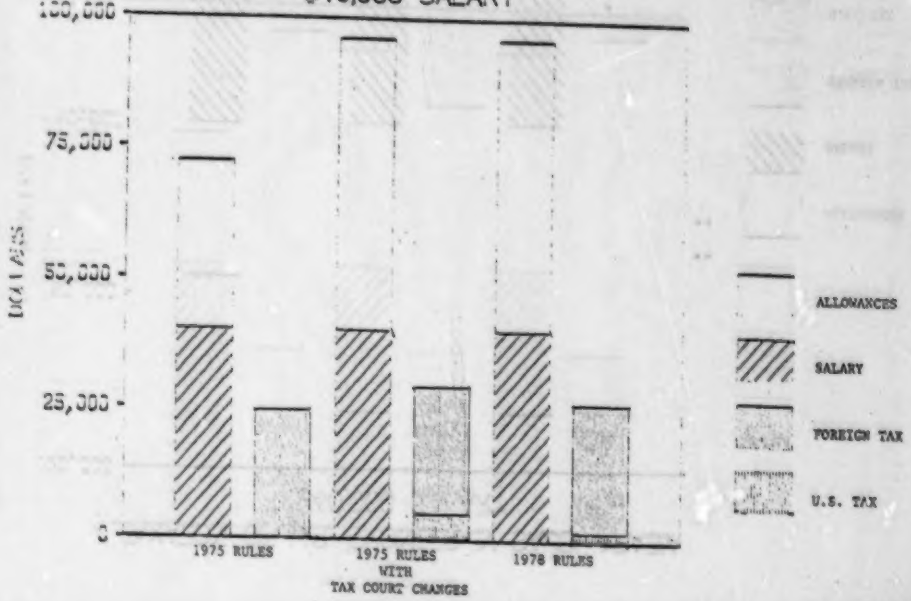
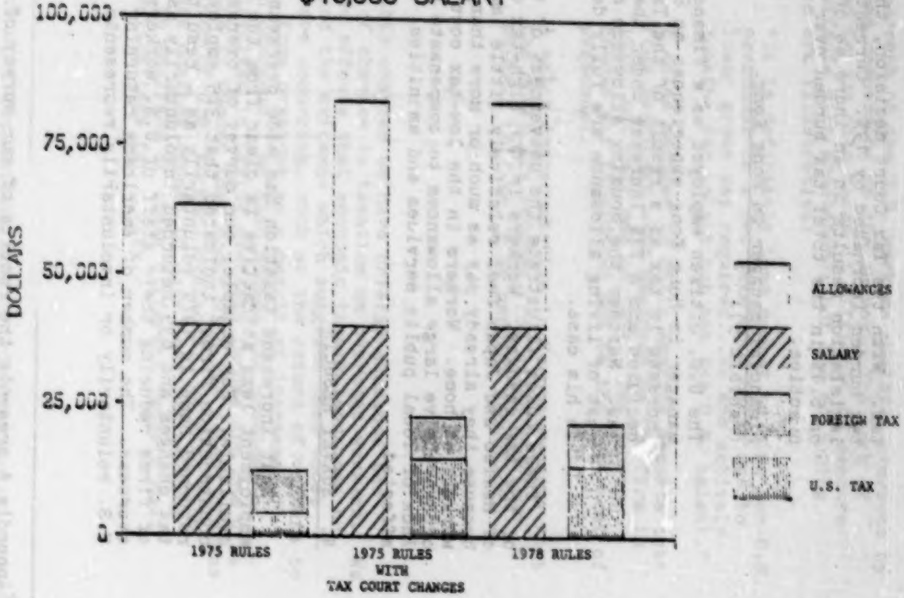


EXHIBIT 5

TAXATION OF U.S. FINANCIAL MANAGER IN HONG KONG
$40,000 SALARY



tax. With the Tax Court decision, the total tax burden increased by 19%. Current legislation results in an increase of $1,591 or 6.4% in the total tax burden over the 1975 practice.

- Financial manager in Hong Kong. (Exhibit 5).

  The U.S. citizen employed as a financial manager in Hong Kong experiences an 83% increase in tax as a result of the Tax Court decision and a 73% increase under the current law. Neither the housing allowance nor the cost of living allowance are fully deductible in his case.

These cases illustrate the unevenness of the impact of the tax changes. Workers in the high-tax countries of Mexico and Japan feel relatively little impact because they already pay as much or more than U.S. workers at home. Workers in the low-tax countries, who often receive large allowances to compensate for the lack of local public services and amenities, are most affected.

4. SURVEY RESULTS

That increased taxation has made overseas employment less attractive is clear from the data now available. For example, our survey of overseas construction firms[2] indicated that 375 employees returned home in 1979 voluntarily as a result of the tax changes and 635 returned involuntarily as a result of firms reducing their staff of U.S. workers overseas. The number of Americans returning to the U.S. voluntarily or involuntarily represents an average of 56 percent of the U.S. workers employed overseas by the firms responding to the survey. The lack of detailed Census data makes it difficult to measure these effects with precision[3]; but the following comments are illustrative:

---

[2] Appendix A presents the results of our survey of U.S. overseas construction firms.

- "It is definitely less costly to hire non-U.S. personnel on a net take home basis due to lower gross pay required...We are actively looking for talent but not for U.S. talent."
- A sales manager in Latin America reports that four Americans were employed by the firm in 1976, but only one in 1979. The service branch was liquidated due to the high cost of personnel.
- A sales representative in Europe reports that the staff was reduced from seven American workers to five, a 29 percent reduction.

* * *

In this chapter we have briefly examined the effects of changes in taxation on overseas workers. We noted the effects that economic theory leads one to expect and the evidence which suggests that those effects are occurring, such as the return of workers to the U.S. from overseas as a result of increased taxation overseas. We also showed the problems of equity involved in taxing overseas income and the wide variations in burden that occur with the recent changes in taxation of U.S. workers overseas. We also note that these changes appear to have been implemented without an analysis of these different impacts and their implications for equity.

---

[3] The 1980 Census of Population, unlike prior decennial censuses, will not include U.S. citizens residing outside the U.S.

In the next chapter, we turn to the examination of the impact of the changes on firms both in the U.S. and overseas which result from these impacts on overseas workers.

IV. IMPACT OF TAX ON FIRMS

Changes in taxes on Americans overseas have a substantial impact on American firms, and the impact is not limited to firms with American workers abroad.

Firms which employ Americans overseas feel the pinch first, in two ways:

- increased costs due to high turnover as American workers return home
- increased equalization costs.

These additional costs must either be passed along to customers in increased prices or absorbed by the firm as reduced income. To the extent that U.S. firms must pass along the added costs as price increases, they become less competitive in world markets. Preliminary indications are that lost business to U.S. firms is substantial. Lost business has an adverse impact on the profit picture of these firms and an even-greater impact on U.S. domestic firms as tied exports and follow-on sales dry up.

The impact of reduced exports reverberates through the economy, resulting in decreases in total employment, in aggregate demand, and eventually in tax receipts themselves. This chapter discusses these effects and the evidence that helps begin to quantify them.

1. HIGHER COST OF KEEPING WORKERS ABROAD HURTS SALES AND NET INCOME

As we have seen, increased taxation of workers overseas reduces the attractiveness of overseas jobs. Thus, if American firms wish to maintain their work forces of Americans overseas, they can do so only at an increased cost. Employers who do not provide equalization payments face high turnover costs, as employees seek to "rotate home" to avoid the tax burden. Companies already report higher turnover and the need to hire third-country nationals as a result of the tax change.

Firms which provide tax equalization for employees face increasing costs. Our survey indicated that equalization of worker's incomes for the 1978 tax revisions cost companies an average of $7,874 per American worker overseas.

The increased costs to firms in keeping Americans stationed in foreign countries must either be absorbed in profits or passed on to customers in higher prices. Each firm must choose how to bear the cost. For example, our survey of construction firms indicates that 62.7 percent or around 2/3 of the increase, is passed on in higher prices. Sellers of high-volume, low-margin products will be more likely to pass along only small increases in product prices. Small firms have fewer options. Sellers of high value-added products (products which have a large human capital component) and sellers of services will be the most severely affected. For these firms, the added costs will represent a relatively large proportion of total volume. Therefore, relatively large price increases will be necessary to recoup the added costs. Service-oriented firms will find themselves faced with sharp reductions in net revenues and lost business as a result of the tax change. It should be noted that these firms are the very ones which the President's Special Trade Representative has identified as the source of future U.S. export growth. However, such growth cannot occur if these firms are unable to remain competitive due to higher costs.

2. AMERICAN FIRMS FIND IT MORE DIFFICULT TO COMPETE AND WILL CONTINUE TO LOSE BUSINESS AS A RESULT OF THE TAX CHANGE

The exact magnitude of lost business is very difficult to determine; but construction firms included in our survey indicate that they lost at least $1.2

billion in sales in 1979 (approximately 27 percent of their 1979 overseas sales) because of the increased tax on employees. The following comments by firms indicate both the nature of the impact and the difficulty in measuring it with any real accuracy.

- A health care firm reports that "certainly some impact took place but high market penetration makes it difficult to measure."
- A sales representative firm reports that "with proper American staffing sales could have been increased 25 to 50 percent."
- A chemical firm manager reports $1 million in lost business and states that they are looking for third-country nationals or locals to take over jobs.
- A construction company reports that bids rose an average of 20 percent in labor costs as a result of the tax change, and $100 million worth of business was lost over the 1976-79 period.
- A design and construction firm reports lost business worth $25 million and a loss of 25 American jobs. This amounts to between a third and a half of the firm's total overseas business.

3. THE NUMBER OF AMERICAN WORKERS OVERSEAS DIRECTLY AFFECTS U.S. EXPORTS

The reduced profits and lost business indicated above have serious implications for the rest of the economy. Reduced profits translate directly into reduced tax receipts and lower returns to shareholders. Lost business also results ultimately in lower profits, but it has the potential for much larger and more serious impacts.

The presence of Americans overseas helps generate export business. In response to GAO's 1977 survey, 88 percent of overseas affiliates of U.S. companies estimated that U.S. exports would decline by at least 5 percent if the 1976 legislation were implemented. In addition, a 1978 study by Treasury's Office of Tax Analysis projected that a decline of 10 percent in the number of overseas workers would result in a 5 percent decline in real exports. Many overseas Americans are involved in work which involves substantial procurements or the potential for large amounts of follow-on work. They also tend to be employed in highly skilled positions, thus involving the export of high value-added services rather than lower value-added commodities and products.

The reduction in exports due to the tax change is difficult to quantify with precision, but responses from hard-hit firms are indicative of the type of effects which have occurred as a result of the Tax Court decision and the 1978 legislation:

- A manager of a manufacturing firm indicated that the quantity of machinery and other goods imported from the U.S. dropped 60-70 percent when a local employee replaced the sole American.

- An American sales representative commented that "TCNs do not have the dedication to sell USA products as qualified American salesmen would, nor are they as dedicated in managing American interests. The 1976 tax bill has been a definite deterrent to American interests overseas. Because of its impact, we are no longer offering overseas positions to Americans."

- An engineering construction firm operating overseas indicated that a $2-4 million feasibility study could result in a several hundred million dollar contract. Clients tend to favor expanded or duplicate facilities. They generally consider similar design and similar equipment to reduce their maintenance costs. If the company loses small contracts in the short term, these losses are compounded later on.

- A design and building firm reported that 70 percent of needed materials was procured from the U.S. in 1977, but that the figure had declined to 20% as a result of fewer Americans working on overseas projects.

- An engineering firm representative reported that each $1000 in engineering contracts for their firm resulted in about $10,000 worth of construction follow-on work. The firm's specifications of materials "cannot help but favor procurement of American goods because these are the goods with which we are most familiar."

Finally, two points about the distribution of the impact among firms should be noted:

- The GAO report found that the impact of the tax change is greatest on those companies which are heavily reliant on U.S. workers, such as the building/construction and service sectors. These types of companies tend to have a high proportion of labor costs to total costs.

- Treasury's own analysis indicates that by far the largest average increase per tax return will be in the Middle Eastern and African OPEC Countries. (See Exhibit 1) These countries can be classified as developing countries which are growing export markets for the U.S. The loss of a "foot-in-the-door" position in these countries will have a profound impact on future exports.

These changes have occurred as a result of the relatively small changes in the tax provisions made in 1978. If the government were to do away with all exclusions and deductions on overseas income, the effects can be expected to be much greater.

Conversely, a return to the status which existed prior to 1976 would have an opposite impact.

* * *

In this chapter, we have reviewed the arguments and the evidence concerning the impact of increased personal taxes on U.S. overseas workers on the exports, expenses, and profits of U.S. firms, both at home and abroad. We have noted the difficulties in trying to measure these impacts with great precision; but these difficulties of precise measurement should not be allowed to obscure the basic points, which we believe are clearly established:

- The tax raises the costs and reduces the net revenues of firms operating abroad.
- The greatest impact is in areas where the opportunity for future market share in expanded markets is reduced.
- Domestic U.S. firms are impacted by reduced tied export sales and reduced U.S. representation overseas

In the next chapter we will examine the impact these effects on individuals and firms have on the overall receipts and expenditures of the U.S. Treasury.

V. IMPACT OF TAX CHANGE ON THE U.S. TREASURY

The preceding chapters reviewed the impact of the tax changes on U.S. workers and firms. With that foundation, this chapter shows what the implications of those impacts are for the Treasury. How do reduced job opportunities, higher labor costs, and reduced exports affect tax receipts and expenditures? That is the question we will address in this chapter.

1. TREASURY ESTIMATED "TAX EXPENDITURES" OF $498 MILLION FOR THE PRE-1976 LAW, IGNORING LIKELY RESPONSES BY TAXPAYERS, EMPLOYERS, AND FOREIGN BUYERS

The Treasury Department has argued that a significant amount of additional revenue could be collected if all money and imputed income of Americans overseas were taxed. In a 1978 study, Treasury calculated the expected gain in revenue of doing away with the Section 911 exclusion to be $498 million over the pre-1976 law. However, because of the assumptions used by Treasury analysts, the revenue gains are significantly overstated. A careful analysis indicates that the overall impact of the law is to reduce total U.S. income and hence to reduce tax revenue.

Treasury computed its estimates of "tax expenditure" on the premise that taxpayers would not act differently because of the tax itself. Yet it is clear that a large share of U.S. workers are reacting to the Tax Court ruling and the 1978 legislation by returning to the U.S.

Treasury also assumed that all taxes collected under the revised law are net additions to the Treasury; but, in order to induce workers to remain overseas, employers are paying extra amounts to neutralize the impact of the tax on individuals. These equalization payments reduce the net income of the employers and, hence, reduce the income taxes paid by employers. For every dollar paid out of company income as tax equalization to overseas workers, income taxes paid by the firm are reduced by 46 cents (at the 46 percent corporate income tax rate).

These two factors alone mean that the Treasury estimates of "tax expenditure" overstate the true potential net revenue by some 200-300 percent.

Return to the U.S. of 30 percent of those taxpayers affected by the overseas tax provisions would reduce the revenue yield computed by Treasury by approximately the same fraction -- 30 percent. (Since those most greatly impacted in dollar terms are most likely to come home, the percent reduction in Treasury revenue is likely to be somewhat higher than the percent of workers who return to the U.S.; hence, it is conservative to say the two proportions are the same.) Thus, if the return of overseas workers were taken into account, Treasury's estimated "tax expenditure" of $498 million would immediately be reduced to about $350 million.

Equalization benefits that leave the overseas worker exactly neutral with respect to the tax change will be equal to the initial cost of the tax to the workers plus the additional amount needed to compensate for the tax due on the equalization payment itself. The cost of equalization to firms is therefore equal to (or greater than) the direct tax revenue, if all workers who remain overseas are exactly equalized. Assuming for the moment that there is no loss in overseas sales due to increased costs passed on to customers, the income of firms is reduced by the amount of equalization costs; and income taxes paid by these firms are reduced accordingly. Given a corporate income tax rate of 46 percent, along with an equalization cost exactly equal to the tax revenue, an increase in personal income taxes from Section 911 of $350 million would be immediately offset by a drop in corporate income taxes of $161 million, leaving a net gain to the Treasury of about $189 million.

While precise figures are not available, reasonable estimates such as these reduce expected net revenue from Treasury's $498 million to a much lower $189 million -- a 62 percent reduction.

If, in addition to these two obvious corrections to the Treasury estimates, we take into account the effect of lost exports, increased unemployment, and enforcement costs on tax receipts and expenditures associated with the tax changes, the economic case against the tax becomes overwhelming, as the next section shows.

2. LOST EXPORTS DUE TO THE TAX CHANGE REDUCE OVERALL TAX RECEIPTS MORE THAN THE TAX EXPENDITURE UNDER SECTIONS 911 AND 913

Treasury's method of computing "tax expenditure" assumes away the possible effects of changing the tax provisions on U.S. exports and, more importantly, on U.S. tax receipts affected by exports. Our analysis shows that to be an "oversight" of overwhelming proportions since tax revenues lost as a result of reduced exports would exceed by many times over the tax expenditures under Sections 911 and 913 within the first year.

The impact of the tax change on exports varies widely among countries and depends on the specific structure of taxation in each location. There is also a time lag between the time the tax is imposed and the time export shipments decline, since orders are placed months ahead of actual shipment. These factors make it difficult to measure the decline in exports with precision; but they do not obscure the basic points, supported by economic theory, survey results and prior studies:

- increased taxation reduces the attractiveness of overseas employment and the supply of workers to fill such jobs
- exports are reduced by the reduction in U.S. workers overseas

The evidence from our surveys and from prior studies indicates that the reduction in exports is on the order of 5 percent. We will therefore use that as the starting point for our analysis, acknowledging that the number could be either somewhat higher or lower.

To analyze the impact that a 5 percent reduction in real exports will have on the U.S., we used the Chase Econometrics U.S. Macroeconomic Model to simulate such a situation. The results are summarized in Exhibit 6, following this page.

When U.S. 1980 real exports are reduced by 5 percent, the simulation shows that 1980 federal tax receipts from personal and corporate taxes fall by more than $6.1 billion. In addition, federal receipts under Social Security drop by $300 million. Thus, the lost tax receipts from reduced exports are many times greater than the taxes paid by overseas workers.

Beyond the impact on the federal treasury, domestic workers and state and local governments will also feel the brunt of the tax change. Unemployment will be increased by about 80,000 in the first year, and that will increase the annual cost of unemployment benefits by an estimated $200 million. In addition, state and local governments will lose some $700 million in 1980 corporate profit taxes and $100 million in personal taxes that they would otherwise have received. The value of tax receipts lost to state and local treasuries from the tax change thus exceeds the taxes that would be paid to the federal treasury by overseas workers.

3. OTHER FACTORS FURTHER INCREASE THE LOSS TO THE TREASURY RESULTING FROM CHANGES IN SECTION 911.

While there is no estimate available of the costs of enforcing the tax provisions relating to U.S. workers overseas, enforcement costs could be expected to increase if overseas deductions and exclusions are removed. The taxation of all foreign earned income, both money income and income-in-kind, will entail considerable enforcement difficulties . Enforcement also imposes a significant additional cost on firms

EXHIBIT 6

Impact of 5 Percent Reduction in Projected U.S. Real Exports in 1980

Reduction in value of U.S. exports (1972 dollars)	$- 6.6 Billion
Reduction in value of U.S. exports (Current dollars)	$-16.2 Billion
Reduction in federal tax receipts (Current dollars)	
- federal corporate profit taxes	$- 5.8 Billion
- federal personal taxes	$- 0.3 Billion
- social security contributions	$- 0.3 Billion
	$- 6.5 Billion
Increase in unemployment benefit payments	$+ 0.2 Billion
Increase in unemployment	80,000 workers
Reduction in state and local tax receipts (Current dollars)	
- corporate profit taxes	$- 0.7 Billion
- personal taxes	$- 0.1 Billion
	$- 0.8 Billion

in the preparation and submission of reports on overseas income in a new form. To illustrate, one firm indicated that handling of tax matters related to its overseas workers accounted for more than 15 percent of its tax preparation costs in 1979.

The tax on overseas workers will also raise other costs of government operations. In its 1978 study, GAO assessed the impact of the overseas tax changes on the cost of operations by other U.S. agencies (not including tax enforcement). Their conclusion was that costs would increase; but the magnitude of the increase is small compared to the revenue losses from reduced exports computed above.

* * *

Changes in the system of taxing foreign earned income of U.S. workers overseas would have major impacts which are difficult to quantify. Nevertheless, the potential for adverse effects on national income and employment are considerable, and revenue estimates which ignore these effects are simplistic at best. Changes in the tax treatment of Americans overseas cause a decline in real exports, which produces a first-year revenue loss to the Treasury many times greater than the increased taxes received from Americans overseas. The loss in state and local tax receipts due to the loss of exports is, by itself, greater than the possible gain (tax expenditure) in federal taxes from U.S. workers overseas.

The appendices which follow present selected data from surveys of firms and details of cases used to illustrate the variation in impact on workers in different countries.

APPENDIX A

SURVEY OF U.S. FIRMS WITH OVERSEAS OPERATIONS

As part of our preliminary assessment of the impact of recent tax changes, we sought information from overseas firms.

With the assistance of the U.S. and Overseas Tax Fairness Committee, a questionnaire was developed for distribution to firms engaged in design, engineering, and construction projects overseas. The results of this survey are included in this report.

In addition, a second questionnaire was developed with the cooperation of the U.S. Chamber of Commerce. This questionnaire was distributed to members of affiliated Chamber of Commerce chapters overseas. The preliminary results of this second survey are also presented here.

This appendix contains compilations of information from both surveys and samples of the survey forms.

Results from the Survey of Firms Engaged in Design, Engineering, and Construction Projects Overseas

		Number of Responses
Number of questionnaires returned:		13
Total cost to company of tax changes:		
In dollars	$22.4 million	10
Per $1000 of 1976 costs of overseas operations (avg.)	$37.34	8
Per American employee overseas (avg.)	$7874	11
Average change in after tax income per employee:		
In dollars, average	$3595	10
As percent of 1976 after-tax income	8.9%	9
Percent of increased company costs:		
Absorbed as decreased profit (avg.)	41%	13
Passed on as higher prices	60.7%	13
Loss of business from tax changes		
Total, in dollars	$1.2 billion	9
As share of overseas business (avg.)	26.7%	7
Reduction in profits		
Total, in dollars	$17.2 million	7
As percent of profits earned overseas	62%	2
Reduction in overseas employment		
Total employees	635	8
As percent of Americans employed overseas (avg.)	45.3%	8
Number of Americans returning to U.S. voluntarily		
Total, 1977-79	375	9
As percent of Americans employed overseas (avg.)	11%	8

Results from Survey of Members of American Chambers of Commerce Overseas

		Number of Responses
Number of questionnaires returned		24
Number of Americans employed overseas, total		
1976	114	23
1977	112	22
1978	121	23
1979	128	24
Value of exports sold, total		
1976	$77.5 million	17
1977	95.5	17
1978	113.4	18
1979	163.8	21
Total additional equalization cost	$674,000	10
Average change in after-tax income, per employee	$7800	5
Percent of equalization cost:		
Absorbed as decreased profits (avg.)	99%	12
Passed on as higher prices	1%	12
Percent increase in product costs due to tax, avg.	2%	7
Percent change in U.S. exports due to 20% replacement of Americans by TCNs (avg.)	18.5%	7

APPENDIX B

COMPUTATION OF TAX OBLIGATIONS IN ILLUSTRATIVE CASES

We prepared four examples to illustrate the impact of current tax structure in different countries. Each example was based on married Americans with two children working overseas earning a salary of $20,000 or $40,000 and drawing allowances for housing, excess living costs, education and home leave. The amounts of the allowances varied among the countries and were estimated from similar case studies in the General Accounting Office's study Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas.

The U.S. tax burden was computed on the U.S. taxable foreign earned income from 1975 tax tables. U.S. taxable foreign earned income is salary and all allowances (before the Tax Court Ruling the housing allowance was not included) minus the 911 exclusion or the 913 deductions.

The 913 deductions were equal to the allowance for education and home leave expenses. The housing deduction was determined in accordance with PL 95-615, and the excess cost of living deduction was drawn from the 1979 Qualified Cost of Living Differential Tables for a family of four. Foreign taxes were estimated using the GAO report to determine income taxable by the foreign country and an average foreign tax rate.

Countries included in this analysis were:

- Mexico
- Saudi Arabia
- Japan
- Hong Kong

These countries were chosen to illustrate the differences in U.S. tax payments associated with differences in local income taxes abroad. Mexico and Japan are both high-tax countries, Saudi Arabia is a low-tax country, and Hong Kong is between these extremes.

EXHIBIT B-1
TAXATION OF U.S. CHARITABLE WORKER IN MEXICO

	1975 Rules	1975 Rules With Tax Court Changes	1976 Rules	PL-95-615 1978 Rules
Salary	20,000	20,000	20,000	20,000
Allowances:				
Housing	-	6,636	6,636	6,636
Overseas Premium	6,000	6,000	6,000	6,000
Education	2,436	2,436	2,436	2,436
Home Leave	1,520	1,520	1,520	1,520
Cost of Living	-	-	-	-
Hardship	-	-	-	-
Foreign Earned Income	29,956	36,592	36,592	36,592
Less:				
911 Exclusion	20,000	20,000	-	-
913 Deductions:				
Education	-	-	-	2,436
Home Leave	-	-	-	1,520
Hardship	-	-	-	-
Cost of Living	-	-	-	-
Housing	-	-	-	1,436
Exemptions (4 @ $750)	3,000	3,000	3,000	3,000
U.S. Taxable Foreign Earned Income	6,956	13,592	33,592	27,200
Tentative U.S. Tax	1,182	2,658	9,329	6,812
Less Tax on Exclusion	-	-	3,004	
Net Tentative U.S. Tax	1,182	2,658	6,325	6,812
Income Taxable by Foreign Country[1]	36,592	36,592	36,592	36,592
Foreign Tax[2]	13,539	13,539	13,539	13,539
Foreign Tax Credit	1,182	2,658	6,325	6,812
Less Reduction[3]	-	-	-	-
Net Foreign Tax Credit	1,182	2,658	6,325	6,812
U.S. Tax	0	0	0	0
Total U.S. and Foreign Tax	13,539	13,539	13,539	13,539

See Footnotes Following Tables

EXHIBIT B-2
TAXATION OF U.S. ENGINEER IN SAUDI ARABIA

	1975 Rules	1975 Rules With Tax Court Changes	1976 Rules	PL-95-615 1978 Rules
Salary	40,000	40,000	40,000	40,000
Allowances:				
Housing	-	30,420	30,420	30,420
Overseas Premium	6,000	6,000	6,000	6,000
Education	10,740	10,740	10,740	10,740
Home Leave	5,304	5,304	5,304	5,304
Cost of Living	5,904	5,904	5,904	5,904
Hardship	8,000	8,000	8,000	8,000
Foreign Earned Income	75,948	106,368	106,368	106,368
Less:				
911 Exclusion	20,000	20,000	-	-
913 Deductions:				
Education	-	-	-	10,740
Home Leave	-	-	-	5,304
Hardship	-	-	-	5,000
Cost of Living	-	-	-	6,700
Housing	-	-	-	20,780
Exemptions (4 @ $750)	3,000	3,000	3,000	3,000
U.S. Taxable Foreign Earned Income	52,948	83,368	103,368	54,844
Tentative U.S. Tax	18,562	35,293	47,268	19,567
Less Tax on Exclusion	-	-	3,004	-
Net Tentative U.S. Tax	18,562	35,293	44,264	19,567
Income Taxable by Foreign Country[1]	-	-	-	-
Foreign Tax[2]	-	-	-	-
Foreign Tax Credit	-	-	-	-
Less Reduction[3]	-	-	-	-
Net Foreign Tax Credit	-	-	-	-
U.S. Tax	18,562	35,293	44,264	19,567
Total U.S. and Foreign Tax	18,562	35,293	44,264	19,567

See Footnotes Following Tables

EXHIBIT B-3
TAXATION OF U.S. MARKETING REPRESENTATIVE IN JAPAN

	1975 Rules	1975 Rules With Tax Court Changes	1976 Rules	PL-95-615 1978 Rules
Salary	40,000	40,000	40,000	40,000
Allowances:				
Housing	-	23,628	23,628	23,628
Overseas Premium	6,000	6,000	6,000	6,000
Education	6,290	6,290	6,290	6,290
Home Leave	5,448	5,448	5,448	5,448
Cost of Living	14,644	14,644	14,644	14,644
Hardship	-	-	-	-
Foreign Earned Income	72,382	96,010	96,010	96,010
Less:				
911 Exclusion	20,000	20,000	-	-
913 Deductions:				
Education	-	-	-	6,290
Home Leave	-	-	-	5,448
Hardship	-	-	-	-
Cost of Living	-	-	-	11,200
Housing	-	-	-	13,739
Exemptions (4 @ $750)	3,000	3,000	3,000	3,000
U.S. Taxable Foreign Earned Income	49,382	73,010	93,010	56,333
Tentative U.S. Tax	16,751	29,375	40,986	26,356
Less Tax on Exclusion	-	-	3,004	-
Net Tentative U.S. Tax	16,751	29,375	37,982	26,356
Income Taxable by Foreign Country[1]	66,934	66,934	66,934	66,934
Foreign Tax[2]	24,765	24,765	24,765	24,765
Foreign Tax Credit	16,751	24,765	24,765	24,765
Less Reduction[3]	-	-	2,115	-
Net Foreign Tax Credit	16,751	24,765	22,650	24,765
U.S. Tax	0	4,610	15,334	1,591
Total U.S. and Foreign Tax	24,765	29,375	40,099	26,356

See Footnotes Following Tables

EXHIBIT B-4
TAXATION OF U.S. FINANCIAL MANAGER IN HONG KONG

	1975 Rules	1975 Rules With Tax Court Changes	1976 Rules	PL-95-615 1978 Rules
Salary	40,000	40,000	40,000	40,000
Allowances:				
Housing	-	20,268	20,268	20,268
Overseas Premium	6,000	6,000	6,000	6,000
Education	4,968	4,968	4,968	4,968
Home Leave	6,680	6,680	6,680	6,680
Cost of Living	5,880	5,880	5,880	5,880
Hardship				
Foreign Earned Income	63,528	83,796	83,796	83,796
Less:				
911 Exclusion	20,000	20,000	-	-
913 Deductions:				
Education	-	-	-	4,968
Home Leave	-	-	-	6,680
Hardship	-	-	-	-
Cost of Living	-	-	-	800
Housing	-	-	-	9,920
Exemptions (4 @ $750)	3,000	3,000	3,000	3,000
U.S. Taxable Foreign Earned Income	40,528	60,796	80,796	58,428
Tentative U.S. Tax	12,393	22,722	33,802	21,467
Less Tax on Exclusion	-	-	3,004	-
Net Tentative U.S. Tax	12,393	22,722	30,798	21,467
Income Taxable by Foreign Country[1]	62,533	62,533	62,533	62,533
Foreign Tax[2]	8,345	8,345	8,345	8,345
Foreign Tax Credit	-	-	839	-
Less Reduction[3]	-	-	-	-
Net Foreign Tax Credit	8,345	8,345	7,509	8,345
U.S. Tax	4,048	14,377	23,289	13,122
Total U.S. and Foreign Tax	12,393	22,722	31,634	21,467

See Footnotes Following Tables

FOOTNOTES

1. The items included in gross income taxable by foreign country were:

Hong Kong - all items except home leave. Housing allowance included as 10 percent of all other items.

Japan - all items except home leave and housing allowance.

Mexico - all items included.

2. The average tax rates were:

Hong Kong - 14 percent

Japan - 37 percent

Mexico - 37 percent

Saudi Arabia - no personal income tax

3. Foreign tax credit reduced for taxes allocable to the 911 exclusion.

STATEMENT OF ROBERT SHRINER, CHASE ECONOMETRICS, WASHINGTON, D.C.

Mr. SHRINER. Senator, with your permission I would like to enter Chase Econometrics' entire study as a part of the record, and confine my remarks to a few brief comments.

Senator CHAFEE. Yes, fine.

Mr. SHRINER. Basically, I would like to give you a little background on the methodology and objectives of our study and some of the principal conclusions. We were commissioned by the Overseas Tax Fairness Committee in early May to initiate an independent appraisal of the economic impact of sections 911 and 913, and we have approached that in a multiphased study of which this report is the first phase.

In this first phase, which we have done within the last 2 months, three steps were included. The first was to review the prior work which had been done by GAO, by Treasury, by many private sources, and by other Government agencies. Second was to gather more up-to-date information to take into account the 1978 revisions. Most of the prior studies had addressed the 1976 proposal. To do this we undertook two surveys. The first addressed the impact on construction firms overseas, and was undertaken in conjunction with the National Constructors Association. The second, much larger survey was developed in conjunction with the U.S. Chamber of Commerce and will go beyond construction firms, surveying all other kinds of firms in 42 countries.

We have the complete results from the survey of constructors. We have preliminary results at this time from the Am Cham organizations.

The third step was to try to get some appraisal of the economic impact. We started out with the premise that there was an effect on exports. We tried to determine the magnitude of that effect on exports, and then after having done that, tried to determine the direct impact on the U.S. economy of that change in exports.

I would like to start by summarizing very quickly the results of the survey, because I think they are very important for getting a good understanding of what came later on. As you can see on the chart to your left, we found that the average annual reduction in after-tax income per employee for Am Cham members was $7,800; for construction workers it was $3,600. This is without equalization by the employer, this is the pain, if you will, felt by the individual employee.

Individual responses varied widely, in some cases as high as $35,000 and other cases as low as $2,500; but the averages for the respondents are the figures shown.

The reduction in the number of U.S. workers abroad reported by constructors was 56 percent. For the Am Cham members, this is more difficult to determine. On an aggregate basis, it stayed about the same or perhaps slightly increased; but that increase seemed to be concentrated in a couple of specific countries. Since we have not yet completed the country analysis, we are not prepared to say what the reduction is; but in many countries we do see individual decreases for Am Cham's as well.

The increased cost to employers reported from the survey was $5,300 for Am Cham members and $7,800 for constructors. That represents an additional cost of doing business to each of these firms per number of workers.

We asked the firms what they would estimate to be the increase in cost of the product or service which they were selling overseas as a result of this change. The answers we got are shown on the chart. For Am Cham members, a 2-percent increase. For constructors, a 10-percent increase.

Senator CHAFEE. Let me just ask a question. In the first line, is the reduction in after-tax income a result of this law going into effect?

Mr. SHRINER. As a result of the 1978 law.

Senator CHAFEE. The 1978 law?

Mr. SHRINER. Yes.

Senator CHAFEE. In other words, it boosted the construction worker or lessened his aftertax income by $3,600?

Mr. SHRINER. That is if you neutralize for any equalization provided by the employer. Now, in some cases there is equalization provided by the employer, and that is not necessarily the same number.

Senator CHAFEE. You must assume there is some kind of equalization if the costs go up in the bottom.

Mr. SHRINER. Yes. What we are trying to do in that particular point is simply determine what the magnitude of the impact is that has to be equalized.

Senator CHAFEE. Yes, I see.

Mr. SHRINER. That is the starting point for the equalization. Now, the full report provides much more detail and, obviously, I have summarized and condensed a great deal here.

Senator CHAFEE. All right. Go ahead.

Mr. SHRINER. The principal point to come out of this is that the impact on the individual is very high. It is very high! From that, it is clear why people are coming home: Either they get equalization to induce them to stay there or, without equalization, they are compelled to come home. With equalization, workers may be willing to stay there, but then that translates into additional costs for the firms themselves. We have tried to examine both of those kinds of things.

Now, the other interesting thing is that, as I indicated, we looked at what prior research had been done, and I think it is interesting to note that——

Senator CHAFEE. But if they come home, they are not any richer.

Mr. SHRINER. No.

Senator CHAFEE. They may be happier or less miserable.

Mr. SHRINER. They simply are escaping the additional taxes or the reduction in real income they would have by staying overseas without equalization.

Senator CHAFEE. Well, not really. If you are making $30,000 abroad, and prior to 1978, let's say, you could keep it, and after 1978, you lose, let's say, $7,800, if you come home and get a $30,000 job, you are not going to be any better off than you were overseas.

Mr. SHRINER. No; that is true.

Senator CHAFEE. You may be more comfortable, but you are not financially going to be any better off. Right?

Mr. SHRINER. That is true. That is true.

The individual can come back home and escape that additional——

Senator CHAFEE. In other words, the effects of the 1978 law are harmful to U.S. industry, to businesses in their competitive position, but they are not harmful to the individual. One, if the individual gets the compensation, the extra compensation, he makes out all right. Am I right?

Mr. SHRINER. Not entirely, Senator. If one is a sole practitioner or self-employed.

Senator CHAFEE. No, let's set him aside.

Mr. SHRINER. OK.

Senator CHAFEE. We are talking American business abroad.

Mr. SHRINER. If he is equalized——

Senator CHAFEE. If he is equalized, he makes out all right, but the company loses——

Mr. SHRINER. That is right.

Senator CHAFEE [continuing]. Because they have to pay him more, therefore, they can't compete.

Mr. SHRINER. That is right.

Senator CHAFEE. Now, if he is an individual practitioner, he loses out, but he would lose out if he were back here. I mean, if he were in Brazil, he has to pay the U.S. tax, but if he is in Schenectady, he has to pay the U.S. tax, too.

Mr. SHRINER. Our study has not addressed the question of the sole practitioner, because that represents a relatively small percentage of the total dollars, but what we have tried to do is concentrate here on where the magnitude of the dollars are.

Senator CHAFEE. Yes. In other words, it seems to me that this is the law that is harmful to U.S. business' competitive position.

Mr. SHRINER. Without a doubt.

Senator CHAFEE. All right. Go ahead.

Mr. SHRINER. Now, as I said, we wanted to see how the results we were getting compared to earlier studies, and recognizing that these are, at best, imperfect results. There is not adequate data to provide a detailed determination of the magnitude of export changes on a country-by-country basis—that is still unfolding during the current year. What we are trying to do is get out ahead of the official statistics and find out what is happening, and we wanted to calibrate the results we got from our survey with the much larger survey that was done 2 years ago by GAO, because we knew what the magnitude of the impacts of that were.

Senator CHAFEE. Now, did GAO really do that survey? That is the trouble. We keep hearing about that 5 percent figure.

Mr. SHRINER. The GAO study says that it did.

Senator CHAFEE. The GAO says they did the study?

Mr. SHRINER. Yes. The GAO report says that 88 percent of the firms doing business overseas reported that they expected a 5-percent reduction in the magnitude of exports as a result of the additional cost of the 1976 changes.

Senator CHAFEE. You have seen the GAO study?

Mr. SHRINER. Yes; I have read it personally, Senator.

Senator CHAFEE. All right. Thank you.

Mr. SHRINER. In addition to that, we looked through some other things that had been done. We found that Treasury itself had a study that was done in 1978 that took a look at what the effect of the legislation was likely to be. It did a detailed statistical cross-section analysis of 26 countries and tried to separate out all of the things that you would want to neutralize for if you were just looking at the relationship between number of workers overseas and exports. That study had several conclusions; but one of the significant conclusions was that if you had a 10-percent change in the number of workers overseas, you would have about a 5-percent change in the magnitude of exports.

The analysis that was included in that Treasury study and also the analysis in the GAO report were consistent with the results we were getting, so we then said, "All right, now, let's see what the impact is of a change in the level of exports. What feedback effect does that have on the U.S. economy?" Our concern was that as a result of the change in taxes, we were driving up costs. That in turn was reducing exports. The reduction in exports was having a feedback effect in terms of lost work within the United States, which in turn would impact on Treasury's own revenues from domestic workers. We wanted to get a handle on that.

So, what we did was take the 5-percent as a basis for the analysis. I am not prepared to say that 5-percent is a precise number; but I think it is a reasonable and appropriate number. It may very well be higher than that. It is possible that it is less than that, but let's take the 5 percent.

If I can now see the next chart——

Senator **Chafee**. Now, I'll tell you, this is a long, complicated study. We can't go into this in detail. I went to the presentation the other day, and I think we will be calling on you in the future as we try to reinforce our case with Treasury. How much are you going to go through it here?

Mr. **Shriner**. I just want you to see one more chart, and we can stop at that point.

The point that I want to make is the impact from that 5-percent change in U.S. exports in 1980. We concentrated just on the first year, because a couple of the things that had been done in the past suggested that there was almost no first year impact. We have not figured here what the total cumulative impact over a number of years is, but we have just looked at the first year's impact.

As a result of the first year's 5-percent reduction in 1980, compared to what our baseline forecast was, we found that a 5-percent reduction in exports led to a total of about $6.5 billion in reduced revenues to the U.S. Treasury: $5.8 billion of that in reduced profits taxes, about $300 million in personal income taxes, and about the same amount in lost social security contributions.

Interestingly, there is also a significant impact at the State and local level: a substantial reduction in State and local tax receipts caused by that reduction in U.S. output, a $700 million reduction in corporate profits taxes, and about a $100 million reduction in State and local personal income taxes.

Now, if you are uncomfortable with the 5-percent figure that we used, you can take the results in proportion. If you say that I am 500 percent off, it is only 1 percent, but you still have a reduction in Treasury revenues that is on the order of $1.5 billion compared to the $400 million or so that Treasury is getting in the way of receipts from that.

Senator **Chafee**. Well, I hear you, but I must say, it seems awfully big. I mean, I want to put forth as strong a case as I can here.

Mr. **Shriner**. It is bigger than I thought it was going to be when we started.

Senator **Chafee**. Well, it is impressive.

Mr. **Shriner**. To play the other side for a minute——

Senator **Chafee**. What did you think when you came up with these figures? Were you a little astonished?

Mr. **Shriner**. Well, I expected the results to be significant. The order of magnitude was larger than I had anticipated, quite frankly.

Senator **Chafee**. You haven't left anything out, have you? [Laughter.]

Mr. **Shriner**. I don't think so. In fact, the question we keep being asked is with regard to our unemployment figure, which is lower than the figure which Commerce and some other people have talked about. For every billion dollars worth of exports, you lose something like 70,000 or 80,000 jobs. I think that is the number that Commerce has cited. Basically, I think that is a long-term number—that is, a comparative statics number—that said what happened if you would let it work through fully.

What we've got here is a number that represents the number of lost jobs during the first year due to that 5-percent change.

So, we have tried to be consistent. Contrary to what some people have suggested, we haven't tried to exaggerate. I have done my best to be as conservative as possible, and I will stand behind that. I think I can show in detailed discussion that it is pretty conservative all the way along.

Senator **Chafee**. Was this on the elimination of all the tax?

Mr. **Shriner**. This analysis is based on the magnitude of tax that is now being imposed.

Senator **Chafee**. Yes, that's right, and so that costs the 5 percent.

Mr. **Shriner**. That is right.

Senator **Chafee**. Fine. Thank you. Thank you very much. We will be talking with you more on this. We have copies of the study.

Mr. **Culpepper**. Mr. Chairman, may I interrupt just a minute?

Senator **Chafee**. Yes.

Mr. **Culpepper**. I was just handed a note that one of the Senators on the floor just called this report a fraud. I would like the record to reflect that although the Tax Fairness Committee commissioned this report, we had nothing to do with the results, and that they were completely independent, to the best of our knowledge.

Senator **Chafee**. Well, I wouldn't be troubled by everything that is said on the floor of the Senate. [Laughter.]

You would spend a lot of time worrying, if you worried about everything that is said over there.

Mr. Fisher?

STATEMENT OF LARRY FISHER, FLUOR CORP., IRVINE, CALIF.

Mr. **Fisher**. Yes. Thank you very much. I will try and make my comments as brief as possible.

I think the key aspect of our statement is an example about a real project in the Middle East, a large process plant. This project has an indicated total cost of approximately $1.8 billion.

The project involves approximately 6.8 million man-hours of design, engineering, and procurement services to be performed in the United States if the job is won by a U.S. firm, and in addition, approximately 4.2 million man-hours in the field involved with local procurement, supervision of the construction.

Briefly stated, under current U.S. law, if we staff this project, and I am talking about the field staff and supervision people, if we staff this project with U.S. employees, our estimate of our labor cost is about $132 million. On the other hand, if the job is totally staffed with U.K. employees, we estimate that the total cost would be approximately $70 million.

This difference of more than $60 million is certainly going to be a factor to be considered by a prospective client in determining the selection of a contractor.

Now, as indicated by Mr. Barnard from Bechtel, to some extent that differential is due to the differing salary rates for United Kingdom versus United States. So, we also looked at this project and said, OK, let's say that we had a total exemption here in the United States, and we want the employees to get the same net take-home pay that they would get under the current law. What, then, would we have to pay them? What would our total labor costs be?

That would reduce our total labor costs to approximately $93 million, which means that there would be a $39 million change in the labor costs and in the labor factor of our bid due to that change in the tax law. We think that that would be a significant factor that the client would take into account.

Senator **Chafee**. What do you think of Mr. Lubick's proposal, which he seemed to be sounding out, this targeting idea? You know, he would target the construction workers?

Mr. **Fisher**. Yes. I am giving you a construction example because that is——

Senator **Chafee**. That is your business.

Mr. **Fisher**. I think the problem is broader than that, and I think you will hear from other people.

Senator **Chafee**. Well, I want to ask the chamber people the same question. What if it only applied to what you might call hardship posts, such as Saudi Arabia, the Middle East, and Indonesia?

Mr. **Fisher**. Well, I think what we are really talking about is being competitive, and we may have a nonhardship area that is a low foreign tax area. If you are really trying to make this competitive, I think using another rationale is going to give you unintended results.

Senator **Chafee**. That is right. You compete in what you might call Western Europe, or builtup places, nonhardship places? I mean, for instance, do you compete in West Germany, Japan, and England? Well, you may have subsidiaries there.

Mr. **Fisher.** To some extent we do.

Senator **Chafee.** In western Europe generally.

Mr. **Fisher.** The bulk of our overseas business in the last 10 years has been in the Middle East. That is where the action has been. But we try to compete on a worldwide basis. We were just awarded a very large contract in Canada.

Senator **Chafee.** In where?

Mr. **Fisher.** In Canada, the Cold Lake oil sands project.

Senator **Chafee.** Well, fine. Thank you very much, gentlemen. We appreciate it. That study was very helpful.

[The prepared statement of the preceding panel follows:]

STATEMENT BY FRED C. CULPEPPER, JR., PRESIDENT, U.S. & OVERSEAS TAX FAIRNESS COMMITTEE, INC.

THE ISSUE IN PERSPECTIVE

Mr. Chairman and members of the Committee; I am Fred C. Culpepper, President of the U.S. & Overseas Tax Fairness Committee. The committee represents over sixty of the Nation's largest manufacturing and engineering and construction firms with extensive commitments in overseas markets. I am also here on behalf of the members of the National Constructors Association and the American Consulting Engineers Council.

In addition, I'm representing George Fisher and The American Constituency Overseas. ACO represents the individual American workingman overseas whose jobs are threatened under current tax laws. George is here today and is presenting a statement for the record. I encourage you to give special attention to that statement.

With me today are Mr. Larry Fisher of Fluor Constructors, Inc. and Dr. Robert Shriner of Chase Econometrics. Mr. Fisher will present a case history of what's at stake in an actual $2 billion overseas contract for which his firm has been in competition. Dr. Shriner will present the findings of an independent study of the impact which the current U.S. practice of taxing foreign earned income has on U.S. trade flows and on U.S. business and U.S. tax revenues.

Before they present their material I would like to make a few general observations. Americans have been successful entrepreneurs since colonial days when the Yankee clippers plied the seven seas and dominated international shipping. Later as the U.S. started emerging as the premier industrial producer in the world our international trade boomed. Since World War II we aided our allies and our enemies to rebuild their industrial capability. It was a seller's market and we became complacent and really weren't too concerned as the market changed to a buyer's market. Now we find ourselves in the position of trying to recapture our past glory. We can't do it unless we are competitive and aggressive in our pursuit of available business. To do this we must have encouragement by our government rather than continuing disincentives that tend to blunt our efforts.

As you know, the issue we're looking at today—the question of how Americans working overseas should be treated for tax purposes by the U.S. government—has been the subject of intense debate for the past four years. The debate was touched off by the 1976 changes in the tax treatment of Americans working overseas. When combined with two Tax Court rulings that year, they produced negative results no one foresaw.

Fortunately, Congress quickly realized that the 1976 changes would strangle American business activities overseas. It agreed to postpone the effect of those changes until a new approach could be worked out. Even so, the uncertainties set in motion in 1976 profoundly damaged our overseas business activities.

As you know, a compromise measure, now known as the Foreign Earned Income Act of 1978, was passed late that year. At the time, we all thought we could live with it—that we could make it work.

We were wrong.

The remaining tax burden on Americans was simply too great—especially when compared to our competitors in the international marketplace. In some cases, in fact, Americans working overseas were actually worse off than they were under the 1976 code. Furthermore, the 1978 provisions led to extraordinarily complex regulations. Those provisions tended to be very restrictive and almost impossible for American businesses overseas to interpret or administer.

During all of this, the debate has continued. The basic arguments haven't changed.

I'm suggesting to you that of all the trade disincentives currently in operation, none can be reversed as readily or produce more immediate positive results than the current U.S. practice of taxing the incomes earned by Americans abroad.

Action this year—within the next few months—can effectively slow the momentum toward further trade flow deficits and get the flow headed in the other direction. If we do not get action in the next few months, we'll likely be meeting at about this time next year—many more billions of dollars in the hole and with a needless toll in additional U.S. unemployment as Dr. Shriner will show.

We are presenting a great deal of new data to support action now. They prove, beyond doubt, the direct connection between our presence abroad and our exports. But, the data simply document what anyone with experience in foreign markets already knows as a matter of experience and just plain common business sense: If you want people to buy your goods and services, you've got to have a significant presence in the marketplace and you've got to be competitive.

Trade, after all, is a highly social process and depends on our on-the-scene knowledge of the market place, our contacts and visibility and our credibility. In today's international economy—a system our nation substantially created—we can't maintain our place in the market by reducing our presence.

Yet, after all of the data and studies and case histories are assessed today and in the days following these hearings, it will be obvious that we've been trying to do exactly that in recent years—and have dropped from over 23 percent of worldwide market share to less than 14 percent in a decade largely as a consequence.

The engineering and construction industry has been particularly hard-hit, dropping in worldwide share of construction volume from first place four years ago to seventh place currently, and from first to twelfth place—or from over 10 percent of the total to less than 1.5 percent—in the rapidly expanding Middle East market.

I know that some sources continue to dispute the evidence that higher U.S. taxes are forcing Americans to abandon overseas markets and return home: It's happening—in some areas, at rates above 50 percent. I anticipate the greatest flight of Americans from overseas this summer—the time when most Americans tend to relocate. It will set records that will not show up completely in the number of tax returns filed until 1982 because some who return this summer will file under 911 and 913 for 1981.

In truth, given the rapidly expanding overseas markets, our presence overseas should be expanding—at least doubling—not shrinking.

I'd like to make the point that this country's trade policies must also take into account the many non-trade benefits of an American presence overseas—benefits that are, or should be, obvious. It takes little imagination to realize the potential damage to our future influence in the Middle East that stems from the fact that, due almost entirely to U.S. tax policies, the percentage of Americans on the faculty at the University of Petroleum and Minerals in Dhahran, Saudi Arabia, has dropped from 89 percent in the early 1970's to less than 15 percent today. That's where many of the future leaders in the Middle East are now in training. Think what that shift will cost our nation—its vital interests, influence and security—in the years ahead.

This must be stopped.

Our current tax practices wholly ignore the value to the U.S., in the international marketplace, of American dedication, drive, energy and resourcefulness—things we take for granted here at home and that are built into our culture and work ethic. But, anyone with experience knows that they give us a substantial advantage in overseas markets—an enormous appeal—if we can afford to keep Americans in the international marketshare. And that, of course, goes to the issue.

Americans must have incentives to work overseas. They must, at least, be on the same tax footing as the citizens from the competing industrial nations. And we're showing you today that the incentives we need will cost the government nothing. But it will net the government billions of dollars in added real tax revenues.

I thank you for your interest and I hope with your help we'll start to reverse the tendency to penalize Americans working overseas and start acknowledging their contributions to the economic well-being of our country.

U.S. & OVERSEAS TAX FAIRNESS COMMITTEE, INC.

MEMBERSHIP LIST

Anderson, Bjornstad, Kane, Jacobs, Inc., 1300 Dexter Horton Bldg., Seattle, Wash. 98104.

Guy F. Atkinson Company, P.O. Box 593, 10 West Orange Avenue, South San Francisco, Calif. 94080.
The Badger Company, Inc., One Broadway, Cambridge, Mass. 02142.
Bechtel Power Corporation, P.O. Box 3965, 50 Beale Street, San Francisco, Calif. 94119.
Beck International, 4600 1st National Bank Bldg., Dallas, Tex. 75202.
Louis Berger International, Inc., 100 Halsted Street, East Orange, N.J. 07019.
Black & Veatch International, P.O. Box 8405, Kansas City, Mo. 64414.
Boyle Engineering Corporation, P.O. Box 19608, Irvine, Calif. 92713.
Cameron Iron Works, Inc., P.O. Box 1212, Houston, Tex. 77001.
Camp Dresser & McKee, Inc., One Center Plaza, Boston, Mass. 02108.
Caterpillar Tractor, 100 N.E. Adams, Peoria, Ill. 61629.
CBI Industries, Inc., 800 Jorie Boulevard, Oak Brook, Ill. 60521.
CH$_2$M Hill International, 200 S.W. Market Street, Portland, Oreg. 97201.
Continental Emsco Company, Post Office Box 1522, Houston, Tex. 77001.
Culpepper Enterprises, Ltd., Quachita National Bank Bldg., Monroe, La. 71201.
Leo A. Daly, 8600 Indian Hills Drive, Omaha, Nebr. 68114.
Dames & Moore, 445 S. Figueroa Street, Los Angeles, Calif. 90071.
Davy McKee Corporation, 6200 Oak Tree Boulevard, Independence, Ohio 44131.
Dravo Corporation, One Oliver Plaza, Pittsburgh, Pa. 15222.
Dresser Industries, Inc., Elm at Akard, Dallas, Tex. 75202.
Ebasco Services, Inc., Two Rector Street, New York, N.Y. 10006.
Fluor Constructors, Inc., 3333 Michelson Drive, Irvine, Calif. 92730.
Foster Wheeler Energy Corporation, 110 South Orange Avenue, Livingston, N.Y. 07039.
Fugro Inc., 3777 Long Beach Blvd., Long Beach, Calif. 90807.
Gilbert Associates, Inc., P.O. Box 1498, Reading, Pa. 19603.
Gulf Interstate Engineering Company, P.O. Box 1916, Houston, Tex. 77001.
Halliburton Companies, 3211 Southland Center, Dallas, Tex. 75201.
Harza Engineering Company, 150 Wacker Drive, Chicago, Ill. 60606.
Jacobs Constructors, 251 South Lake Avenue, Pasadena, Calif. 91101.
Henry J. Kaiser Company, P.O. Box 23210, 300 Lakeside Drive, Oakland, Calif. 94623.
Lummus Group, Inc., 1515 Broad Street, Bloomfield, N.J. 07003.
Chas. T. Main, Inc., South East Tower, Prudential Center, Boston, Mass. 02199.
McClelland Engineers, Inc., 6440 Hillcroft, Houston, Tex. 77081.
Morrison-Knudsen Company, Inc., P.O. Box 7808, Boise, Idaho 83729.
Pacific Architects & Engineers, Inc., 640 South Building, 1800 M Street, N.W., Washington, D.C. 20036.
The Ralph M. Parsons Company, 100 West Walnut Street, Pasadena, Calif. 91124.
Phillips Petroleum, 685 Information Center Bldg., Bartlesville, Okla. 74004.
Pittsburgh-Des Moines Steel Co., Neville Island, Pittsburgh, Pa. 15225.
Procon International, 30 UOP Plaza, Des Plaines, Ill. 60016.
Raytheon Company, 141 Spring Street, Lexington, Mass. 02173.
Research-Cottrell, Inc., P.O. Box 1500, Somerville, N.J. 08876.
Shannon & Wilson, 11500 Olive Boulevard, St. Louis, Mo. 63141.
Stanley Consultants, Inc., Stanley Building, Muscatine, Iowa 52761.
Stearns-Roger Incorporated, P.O. Box 5888, 700 S. Ash Street, Denver, Colo. 80217.
Stone & Webster Engineering Corp., P.O. Box 2325, 245 Summer Street, Boston, Mass. 02210.
Sundt Corporation, 4101 East Irvington, Tucson, Ariz. 85726.
Sverdrup Corporation, 800 North 12th Boulevard, St. Louis, Mo. 63101.
Teleconsult, Inc., 2555 M Street, N.W., Washington, D.C. 20037.
3 M, 220-13W 3M Center, Saint Paul, Minn. 55101.
Tippetts-Abbett-McCarthy-Stratton, 655 Third Avenue, New York, N.Y. 10017.
Roy F. Weston, Inc., Weston Way, West Chester, Pa. 19380.
Wilson-Murrow, P.O. Box 1648, Salina, Kans. 67401.
Tudor Engineering Company, 149 New Montgomery Street, San Francisco, Calif. 94105.
Dillingham Corporation, P.O. Box 3468, Honolulu, Hawaii 96801.
S. J. Groves & Sons Company, Post Office Box 1267, Minneapolis, Minn. 55440.

Comparison of Tax Policies for Overseas Employees

Country	Tax on Salary	Tax on Incentives/Bonuses	Tax on Benefits (Retirement, Health, Insurance, Etc.)	Tax on Cost of Living Allowances	Tax on Additional Income Earned Out of Home Country	Notes:	Government Subsidies (To Individual)
United States	Yes[1]	Yes	Yes	Yes[2]	Yes	[1] 20,000 exclusion under Section 911 for those in qualified camps. [2] Certain deductions permitted under complex Section 913 tests.	No
Japan	No	No	No	No	No[1]	[1] Rental, interest, etc. on off-shore investments totally exempt from taxation during non-residence status only.	Yes
Italy	No[1]	No	No	No[2]	Complex formulas to discourage foreign investments	[1] Complex non-residency requirements. [2] Limitation placed on daily expenses for home leave and R&R.	Government owned companies
France	No[1,2]	No	No	No	Complex formulas	[1] Assumes accompanied tour/rules for dual residency—unaccompanied—very complex. [2] Recent government policy aimed to encourage more French engineers to accept overseas work.	Government owned companies
Korea	No	No	No	No	No	[1] Most liberal policies with respect to individuals — Korea committed to exports of domestic unemployment.	Yes
Germany	No[1]	No[2]	No	No[3]	Some limitations. Generally liberal.	[1] Complex non-residency requirements aimed at tours of less than 6 months. [2] Complex definitions. [3] Some limitations designed to reduce excesses.	Few
Canada	No[1]	No	No	No	No	[1] Accompanied tour only. If family of head of household remains in Canada all worldwide earnings subject to full taxation.	No
Sweden	No	No	No	No	No	[1] Recently liberalized tax policies in order to encourage acceptance of overseas assignments.	Few
United Kingdom	No	No[1]	No[2]	No	Complex requirements	[1] U.K. recently liberalized tax policies in order to encourage. [2] Some limitations.	Few

Compiled from data provided in *Worldwide Projects* and Business International S.A./Consultex S.A., a multiclient study, *The Expatriate Employee*, 1979.

U.S. TAXATION OF AMERICANS WORKING OVERSEAS: A NEEDED CHANGE IN PRACTICE

OUTLINE

I. U.S. taxation of Americans Overseas operates as "tariff" on the export of U.S. goods and services.

A. The solution is to put Americans overseas on the same tax footing as citizens of the competing industrial nations.

1. No other industrial nation taxes foreign earned income.

2. The other industrial nations are therefore more competitive overseas.

B. U.S. presence in overseas markets is vital to exports.

1. If we want people overseas to buy our goods and services, we've got to have a significant presence in the marketplace, and we've got to be competitive.

2. We can't maintain our share of exports by reducing our presence.

C. U.S. tax policies are forcing Americans to abandon overseas markets and return home as our case histories and data prove.

II. We commissioned Chase Econometrics to perform on independent study assessing the value of an American presence overseas.

A. The Chase study determined:

1. The linkage between the presence of Americans overseas and U.S. export performance.

2. The impact of the downward trends in the employment of Americans overseas on U.S. exports and on U.S. business revenues.

3. The impact on U.S. tax receipts.

4. The overall benefit to our economy.

B. The testimony presents the Chase findings with corroborating data from other studies. In summary:

1. U.S. export loss is about 5 percent for 1980 because of current tax practices.

2. Tax revenue loss is about $6 billion.

3. Job loss is easily 80,000 in first year, much more later—perhaps one million (according to corroborating study by Georgetown Center for Strategic and International Studies).

III. Action is needed in 1980.

A. Americans must have an incentive to go overseas.

B. The incentive—though it involves elimination of taxes on foreign earned income—will not cost government real tax revenues; on the contrary, the government will gain upwards of $6 billion in revenues.

Mr. Chairman and Members of the Committee, The purpose of this statement is to present a review of the case—as supported by recent studies, case histories and trade flow trends—for new tax laws designed to put Americans at work overseas on the same tax footing as the citizens from the other industrial countries with which we must be competitive in worldwide markets.

Two years ago, in material we presented to the Senate Finance Committee, we observed that the continued U.S. taxation of foreign earned income was, for all practical purposes, operating as "huge tariffs" imposed by our own government "on the export of certain goods and services that originate in our own country." We went on to observe of the "tariff" that, "It's pricing us out of competition. It's helping the industrial nations with which we must compete increase their share of the international market at our expense."

The basic problem remains the same today. Despite passage of remedial legislation in 1978—legislation we all hoped would work—the tax burden on overseas Americans continues to remove them from competition.

The only workable solution, as all of the following material demonstrates, is to put American citizens working overseas on the same tax footing as citizens from all of the other nations competing in international markets.

To do less is to deny Americans at home jobs that flow from exports created by the presence of Americans in overseas markets. In the final analysis, the data simply document, in no uncertain terms, what anyone with experience in foreign markets knows as a matter of experience and just plain business sense: If you want people to buy your goods and services, you've got to have a significant presence in the marketplace, and you've got to be competitive.

Trade is a highly social process and depends on our on-the-scene knowledge of the marketplace, our contacts and visibility and our credibility. In today's international economy—a system our nation substantially created—we can't maintain our place in the market by reducing our presence. On the contrary, we should be doing everything we can do to increase it. Yet, after all of the data and studies and case histories are assessed today and in the days following these hearings, it will be obvious that we've been reducing our presence in recent years—and have dropped from over 23 percent of worldwide market share to less than 14 percent in a decade largely as a consequence.

DISCRIMINATORY TAXATION OF AMERICANS

The U.S. is the only nation that taxes solely on the basis of citizenship. Among the industrial nations *only* the U.S. taxes the incomes earned by its own citizens at work in foreign countries.

Because of the added tax premium on Americans overseas, it costs substantially more to employ Americans overseas than it does to employ citizens of other nations. Our data and case histories show the resulting cost of one American in low tax countries can be as much as twice the cost of equally qualified citizens from other nations.

In effect U.S. tax policies discriminate against the employment of Americans in overseas markets.

Here are some examples of the results of the discriminatory tax practices:

One engineering and construction company reported on March 27, 1980 that it now employs 103 Americans overseas, down from 2200 in 1977.

Teleconsult reports that, on a small job in Jordan, "We have had to replace all but 2 of the 14 American engineers with foreign engineers."

Berger International reports that on a project in Nigeria it has been forced to cut its staff of 35 Americans in 1977 to 2 in 1980. The firm further reports that, before 1976, 40 percent of its staffing overseas was American and that by late 1977 the percentage had been cut to 17 percent.

Others report similar experiences:

"Our manpower commitments are increasingly being met by supplying personel from our affiliates in U.K., Italy, France, and Spain. In a major contract in Saudi Arabia, 95 percent of the 300 expatriate supervisors, including those at top level, are supplied by our U.K. affiliate. This work force mix has obvious ramifications as far as purchasing policies are concerned."

"This is to advise that we currently have 3 key positions on a highway construction management project in Kuwait which we have been unable to fill with American because of the potential tax liabilities. Over the past several months we have filled 6 key positions with Englishmen and Europeans because of our inability to recruit American staff."

Aramco notes in a survey completed in February 1980 that, "In 1970, 50 percent of Aramco's expatriate (non-Saudi) workforce of 1,725 employees was American." In contrast, because of U.S. tax practices, Aramco's report continues, "Americans are now only 23 percent of the 16,500 rather employee expatriate workforce and number some 3,800 rather than the 8,200 as would have been the case if U.S. expatriates had remained at the 50 percent level.

Abdullah Dabbagh, A Saudi diplomat, said two months ago in New York that, "Americans are still being taxed out of competition in overseas markets." He notes that in 1976, 65 percent of employees in U.S. firms operating in Saudi Arabia were Americans. The figure is now down to 35 percent.

A study of Jennifer D. Milre, M.A. of the U.S. tax impacts on the presence of Americans in England, points to a 20 percent decline since 1975 despite the fact that England is a high tax country where the impact of U.S. taxes would not be as great.

On the basis of data we've recently compiled and which we're currently evaluating it appears that, as compared to four years ago, we'll shortly have about half the number of Americans overseas largely because the cost of maintaining U.S. workers overseas has risen prohibitively because of U.S. tax practices.

NO CLEAR EVIDENCE

As recently as February 1980, in a covering letter for a U.S. government report entitled "Equitable Tax Treatment of United States Citizens Living Abroad," the observation was made that, "The various studies undertaken on the taxation of Americans living abroad do not yet provide clear evidence of the competitive disadvantage and its impact." The report went on to question the merits of an American presence overseas observing at one point that:

"Employment of Americans abroad may or may not generate goodwill. It would be inaccurate to generalize. In some environments, the presence of Americans abroad has favorable impact; in other environments the impacts may be negative."

Finally, the report goes on to assert that, "Most U.S. export activities take place in the United States," the point apparently being that foreigners who want what we have to offer will come to us; we need not go among them to push our wares.

Given that kind of thinking, which leaves a great deal to be desired just on the face of it, we set about to document the value of "an American presence overseas."

Specifically, we asked Chase Econometrics to undertake an independent study of the impacts of current U.S. tax practices on the capacity of Americans to compete overseas. We asked Chase then to determine the extent to which Americans employed overseas were being replaced by non-Americans. The task for Chase was then to determine:

The linkage, if any, between the presence of Americans overseas and export performance.

The impact, if any, of the downward trends in the employment of Americans overseas on U.S. exports and on U.S. business revenues.

The impact, if any, on U.S. tax receipts.

The overall benefit to our economy.

What follows are the findings to date of the Chase study as augmented by case histories, examples and data collected by our own staff and by our member firms.

LINKAGE

Chase, in its preliminary finding, concludes that:

"The increased cost of employing U.S. workers overseas and the reduction in the number of U.S. workers overseas reduces the competitiveness of U.S. goods and services abroad and results in a substantial drop in exports."

Additionally, with substantial data to back it up, Chase notes that:

"The return of American workers from overseas will increase the domestic labor force but will not increase the number of domestic jobs. Therefore, domestic unemployment increases."

Perhaps most significantly, Chase concludes, after thorough examination of prior studies on the subject, and evaluations using its own well established macroeconomic model of the domestic economy, that there is a direct, causal linkage between the presence of Americans in overseas markets and the sale of U.S. goods and services.

Although there are a number of variables, depending upon market sector and various market biases on a country-by-country basis, Chase concludes that it is generally the case that a 10% drop in Americans overseas leads to a 5% drop in U.S. exports. Chase concludes that that is a conservative general ratio.

The Chase findings intentionally err towards conservative estimates. Findings by the Georgetown Center for Strategic and International Studies, U.S. Export Competitiveness Project, generally corroborate the Chase findings though the Georgetown estimates are that job loss attributable to a $15 billion loss in trade, which corresponds to the Chase trade loss estimate, would be about one million in the domestic economy, after the ripple effect is taken into account over a period of time.

Americans overseas direct business back to the U.S. which creates new demand for more goods and services, which creates new jobs. The linkage is inescapable.

If, however, you choke off part or all of the exports attributable to a direct American presence overseas by writing tax laws that force Americans to return home, you deny yourself the business and the jobs and all of the revenues—corporate and tax—that would flow with it.

JOBS ABROAD, JOBS AT HOME

The general finding of Chase as corroborated by Georgetown and other studies including our own is no surprise to us, though the supporting data, combined with the testing of the data in the Chase model of the domestic economy, add substantial support to our basic thesis.

That Americans at work overseas create new markets for U.S. goods and services and generate new jobs for our domestic economy are reflected, further, in a large number of case histories, a sampling of which we present below:

A member of the U.S. & Overseas Tax Fairness Committee (TFC), which represents 60 large firms attempting to do business overseas, performed an analysis of a loss of 25 contracts in one year with a total value of $1.3 billion and found that:

The losses cost 598 potential U.S. engineering and construction supervisors overseas;

The losses cost conservatively 1,800 jobs in the U.S. for engineering support;

The losses cost $637,594,000.00 worth of goods and services that were to have been purchased in the U.S. or about 13,000 jobs associated with those lost export sales by conservative estimate.

Other engineering and construction firms report that, though judged technically best qualified on the short lists, they've been disqualified on the basis of costs attributable to U.S. tax policies. For 1978, a sampling of major losses to U.S. firms included documented contract losses of $4.157 billion for one, $4.076 billion for another and $1.4 billion for a third.

Berger International reports that it is in trouble in Nigeria (which has a $5 billion surplus position with the U.S.) on a sewage infrastructure project for Abuja a *new* city for 3 million people with 5 *new* satellites of 100,000 to 200,000 people because of its inability to staff with Americans—and faces diversion of equipment sales from the U.S. to the U.K. valued at $36 million for the first phase (or approximately 5% of the total amount).

Tippetts-Abbett-McCarthy-Stratton (TAMS) notes that its "only product is professional services" and that "75 percent of our revenues are generated from overseas contracts." TAMS says that "30 percent of our professional staff is stationed overseas and 60 percent of our home office man-power concerns projects overseas."

LOSS IN INTERNATIONAL MARKET SHARE

We're finding that, since 1976 when Congress reversed long-standing tax exemptions on foreign earned income, our worst fears and projections have proved modest. For example, in that time:

The U.S. engineering and construction industry share of the Middle East market has dropped from over 10 percent to less than 1.5 percent.

Worldwide, we've dropped from first place in contract awards among the competing industrial nations in 1976 to seventh place as of the quarter ending March 1980 for a 4.9 percent share of worldwide construction in 1979 as compared with 16 percent in 1976.

TAX COST THAT IS NOT A TAX COST

The Chase study estimates a loss of at least 5 percent in exports in 1980 as a result of current tax practices and notes that:

"The drop in U.S. income due to a 5 percent drop in real exports will raise domestic unemployment [by 80,000] and reduce federal receipts from personal and corporate income taxes by more than $6 billion, many times the value of increased taxes on overseas workers."

Clearly, reductions in the numbers of Americans at work overseas mean fewer Americans overseas to pay taxes. Fewer American taxpayers overseas mean a smaller tax base overseas. If current trends continue based on available case samplings and corresponding conclusions reached by Chase, the number of Americans working overseas, as compared with early 1976, will soon be cut by half. Likely, seventy-five percent or more of potential new positions that would normally be staffed by Americans will go to non-Americans.

The fact is that the Treasury estimates of the "tax costs" or "revenue loss" of substantially removing taxes on foreign earned income are completely static and assume no change in taxpayer behavior. That assumption, as has been shown, run counter to the facts.

The fact is that there is no actual tax cost if there is no actual tax source. You can't tax people who aren't there.

Using our own data and the data being developed for us by Chase, we find that the maximum real world tax cost to the Treasury, assuming complete elimination of U.S. taxes on foreign earned income, would not exceed $215 million as compared to figures currently being floated by Treasury that range from $495 to over $700 million.

In contrast, as has already been noted, a complete reversal of current tax practices which would effectively eliminate U.S. taxes on most Americans overseas would over a twelve month period result in an increase of at least 5 percent in U.S. exports or more than $6 billion in real net tax revenues. More sales and more jobs mean more tax revenues. Lost sales mean no tax revenues.

It should be noted that if the U.S. were to recapture the market share it has lost since 1969 its trade flow accounts would once again be in surplus on the export side. As matters now stand, due to the taxation of Americans overseas, we face an additional loss of over $16 billion in trade in 1980, and likely more than that each year following.

It is also noted by Chase that if Americans are not overseas generating new jobs, then they're back home absorbing existing jobs at a time when there aren't enough jobs in the domestic economy to go around. They're swelling the welfare rolls—and therefore tax costs—not the tax rolls. Chase estimates that the added welfare costs may be at least $200 million.

The proposal to put Americans working overseas on the same tax footing as citizens from all of the other competing industrial nations at work in foreign countries—what we call competitive tax equity—does not involve a real tax or revenue cost. On the contrary, it will produce a very large net tax revenue gain—and it will do so very rapidly.

HISTORIC CONTEXT

Since 1962 until fairly recently, U.S. tax policy has acknowledged the principle that Americans overseas direct business—and therefore jobs—back to the U.S. domestic economy and, for that reason, should be encouraged to work in foreign markets. That was the whole point of the aptly named Foreign Trader Exemption Act of 1926. The idea was to give Americans, who would not otherwise leave their friends and the comforts of their homes and communities to live in some foreign land with strange languages and customs, an incentive that would make such a move worth their while.

Thus, a tax incentive. It was not the first, nor would it be the last time that the tax system would be employed as an incentive mechanism.

In 1976, after substantial erosion of the original intent as Congress attempted to eliminate abuses—notably by movie stars and high income executives—Congress inadvertently (we believe) eliminated virtually all incentive and, combined with certain Tax Court Rulings that same year, effectively created a very substantial disincentive instead.

As noted earlier, the 1976 changes—and subsequent changes again in 1978—operate as a tariff imposed by our own government on the export of our own goods and services. Thus Americans are, as we've already shown, no longer competitive overseas. In today's price competitive international marketplace, the added costs on Americans are making U.S. firms that must commit substantial manpower resources to succeed overseas unable to recruit or staff with Americans and thus unable to compete. And, of course, that's why Americans are being forced to return home where they are no longer in positions overseas to direct business back to our domestic economy.

DEBATE

A debate, touched off by the 1976 changes in the tax treatment of Americans working overseas, has proceeded for almost four years. Fortunately, Congress quickly saw that the 1976 changes would strangle American business activities overseas. It agreed to postpone the effect of those changes until a new approach could be worked out. Even so, the uncertainties set in motion in 1976 profoundly damaged our overseas business activities.

A compromise measure, now known as the Foreign Earned Income Act of 1978, was passed late that year. At the time, we all thought we could live with it—that we could make it work.

We were wrong.

The remaining tax burden on Americans was simply too great—especially when compared to our competitors in the international marketplace. In some cases, in fact, Americans working overseas were actually worse off than they were under the 1976 code. Furthermore, the 1978 provisions led to extraordinarily complex regulations. Those provisions tended to be very restrictive and almost impossible for American businesses overseas to interpret or administer.

The question is, Where do we go from here?

The answer is not easy, we know. The causes of the imbalances in the trade accounts are many and complex. No one seriously suggests that there is a single cause. Our government has created many export disincentives at a time when it should be creating incentives. We must reverse course.

We suggest that of *all* the trade disincentives currently in operation, *none* can be reversed as readily or produce more immediate positive results than the current U.S. practice of taxing the incomes earned by Americans abroad.

ACTION THIS YEAR

Action this year—within the next few months—can effectively slow the momentum toward further trade flow deficits and get the flow headed in the other direction. If we do not get action in the next few months, we'll likely be meeting at about this time next year—many more billions of dollars in the hole and with a needless toll in additional U.S. unemployment, as the Chase and other studies show.

We know that some sources continue to dispute the evidence that higher U.S. taxes are forcing Americans to abandon overseas markets and return home: It's happening—in some areas at rates above 50 percent. We anticipate the greatest flight of Americans from overseas this summer—the time when most Americans tend to relocate. It will set records that will not show up completely in the number of tax returns filed until 1982 because some who return this summer will file under 911 and 913 for 1981.

In truth, given the rapidly expanding overseas markets, our presence overseas should be expanding—at least doubling—not shrinking.

I'd like to make the point that this country's trade policies must also take into account the many non-trade benefits of an American presence overseas—benefits that are, or should be, obvious. It takes little imagination to realize the potential damage to our future influence in the Middle East that stems from the fact that, due almost entirely to U.S. tax policies, the percentage of Americans on the faculty at the University of Petroleum and Minerals in Dhahran, Saudi Arabia, has dropped from 89 percent in the early 1970's to less than 15 percent today. That's where many of the future leaders in the Middle East are now in training. Think what that shift will cost our nation—its vital interests, influence and security—in the years ahead. It is symptomatic of a process that is in full flood around the world.

It must be stopped.

Our current tax practices wholly ignore the value to the U.S., in the international marketplace, of American dedication, drive, energy and resourcefulness—things we take for granted here at home and that are built into our culture and work ethic. But anyone with experience knows that they give us a substantial advantage in overseas markets—an enormous appeal—if we can afford to keep Americans in the international marketplace. And that, of course, goes to the issue.

Americans must have incentives to work overseas. They must at least be on the same tax footing as the citizens from the competing industrial nations. And we're showing you today that the incentives we need will cost the Government nothing. It will net the government billions of dollars in added real tax revenues.

I thank you for your interest and I hope with your help we'll start to move back toward our proper share of overseas markets this year.

Statement of Lawrence N. Fisher
Senior Tax Counsel, Fluor Corporation
U.S. Senate Finance Subcommittee on Taxation and Debt Management
Hearings on Taxation of Foreign Earned Income
June 26, 1980

My name is Lawrence N. Fisher and I am Senior Tax Counsel of Fluor Corporation. From May 1978 until June 1979 I was a Vice President of Fluor Arabia Limited, a Fluor Subsidiary which performs engineering and construction services in the Kingdom of Saudi Arabia. In both capacities I have had ample opportunity to observe the practical workings and detrimental effects of U.S. taxation of Americans working abroad.

Fluor, headquartered in Irvine, California, provides worldwide engineering, construction, procurement and project management services to energy, natural resources and industrial clients. Fluor's gross sales in 1979 were $3,500,000,000. Fluor's two major engineering offices are located in Irvine (approximately 3,700 employees) and in Houston, Texas (approximately 2,000 employees). As is true for most of the larger engineering and construction companies, foreign projects constitute a significant portion of its business. As of October 31, 1979, foreign projects accounted for 64% of Fluor's backlog. This backlog includes a significant amount of engineering, project management and procurement services relating to foreign projects which will be performed by Americans working here in the United States. Such foreign projects also create significant markets for the export of products and services for other U.S. firms. Dr. Shriner of Chase Econometrics has provided this committee with a detailed and comprehensive macro-economic analysis showing the relationship between exports and the employment of Americans abroad. I would like to present the committee with additional information on this issue from a different perspective; i.e., from the context of a large single engineering and construction project in the Middle East. We feel that this project demonstrates how current U.S. tax policies have hindered the ability of U.S. firms to compete in overseas markets and also illustrates in graphic terms the export sales of both products and services which stand to be lost if engineering and construction projects are awarded to foreign firms.

Background

When Fluor performs a total responsibility project in a foreign country, much of the work is performed in one or more of its permanent home offices. Virtually all of the design and process engineering work, most of the cost engineering, scheduling, purchasing, overall project coordination and management and a significant amount of construction planning will be performed in the U.S. home office. Services to be performed in the field by expatriate personnel include construction supervision, local purchasing, and to a lesser extent project management, cost engineering and scheduling. Craft labor is usually provided by local hires. When local labor sources are insufficient to meet project requirements then craft laborers from low-cost labor areas will be utilized.

The project which we have analyzed is an actual process plant[1/] to be located in the Middle East. The estimated total cost of the plant, excluding any contingency factors is approximately 1.8 billion

---

[1] By "process plant" we mean a facility which operates to refine, upgrade or convert a material ("feedstock") into a product which is one or more steps closer to being fit for use in the consumer market e.g., a petroleum refinery or a natural gas process plant.

dollars. Estimated home office manhours (both direct and indirect) are 6.8 million and estimated field manhours (excluding craft labor) are 4.2 million. In preparing our estimates of field staff costs we have assumed that the field portion of the project will be completed in the 36-month period beginning January 1, 1980 and ending December 31, 1982. The project is representative in terms of size and content to several Fluor projects in the Middle East.

Adverse Competitive Impact

To illustrate the adverse impact of current U.S. tax law we have calculated the estimated field staff labor costs for this project on three different bases:

1) On the basis of 100% staffing with U.S. employees under current law;
2) On the basis of 100% staffing with U.K. employees;
3) On the basis of 100% staffing with U.S. employees if foreign earned income was exempt from U.S. taxation.

Field staff labor costs consist of salaries, including any required tax protection or tax equalization element designed to protect overseas compensation incentives against tax dilution plus living allowances paid to employees who are not provided with meals in the construction camps. The allowance covers only the "excess" cost of food, etc., over comparable costs in the U.S.

Salary costs were calculated on the basis of our current salary levels in Saudi Arabia for U.S. and U.K. employees. Our salary levels for both U.S. and U.K. employees are competitive with the marketplace.

Under current law, field labor costs would be approximately $132.6 million if the project is staffed with U.S. employees. Approximately 25% of this amount reflects the U.S. tax costs for these employees. However, if the job is staffed with U.K. employees rather than U.S. employees, field labor costs would be approximately $69.7 million. This difference of $62.9 million is an apparent net cost saving to a client, which may be a critical factor in the selection of a contractor.

However, if U.S. employees were exempt from U.S. tax and if we assume that salaries would be adjusted so the U.S. employees would receive the same pay they would have received after tax under current law, then total field staff labor costs would be reduced from $132.6 million to $93.5 million. This substantial reduction of more than $39 million (a 29% reduction) in labor costs would go far towards making a U.S. firm using U.S. employees more competitive in overseas markets.

The bulk of the expense to the project is for materials which clients assume will be relatively comparable in cost between contractors of different countries. Thus, it is comparative labor costs that clients primarily look to in evaluating the cost competitiveness of contractors.

Impact on U.S. Exports

A reduced share of the world market for U.S. engineering and construction firms would have effects reaching far beyond the loss of business by the firms themselves and the loss of jobs by its overseas employees. U.S. manufacturing firms rely heavily upon the engineering and construction industry for export business. U.S. technicians and procurement personnel tend to specify U.S. goods and materials. Since 1972, Fluor alone has purchased more than $2.9 billion of U.S. goods and materials for use on foreign projects. These purchases provide U.S. manufacturing firms with market penetration throughout the world. If overseas projects were lost to foreign firms, the amount of U.S.

purchases would be drastically reduced. For example, Exhibit "A" attached shows U.S. purchases on a Fluor oil refinery project and U.S. purchases on the same type of project in the same country performed by a foreign firm. On the Fluor project, U.S. purchases accounted for 40.2% of the total, compared to only 7.3% on the foreign project. On a single major project this translates into hundreds of millions of dollars of lost exports. Shortly after the passage of the Tax Reform Act of 1976, Fluor surveyed its major U.S. suppliers. Two questions were posed:

1. "What would be the impact on your manufacturing program if, because of 911, U.S. contractors were squeezed out of foreign construction work?"
2. "What percentage of work would you expect to receive from foreign contractors if they picked up the work which would historically be won by U.S. firms if it were not for Section 911?"

Memoranda summarizing representative responses are attached as Exhibit "B". Most suppliers indicated that loss of U.S. engineering and construction work would significantly affect their business and that this business would not be replaced by orders from foreign firms.

In summary, loss of foreign projects to firms from other nations will mean less export business for U.S. manufacturing firms. It will also mean fewer jobs for U.S. employees overseas and in the United States.

For example, the potential market for U.S. exports created by the Middle East Project we have been discussing is $881 million, broken down as follows:

Materials and equipment to be incorporated into the plant	$530,000,000
Temporary construction facilities	27,000,000
Construction consumables	27,000,000
Equipment consumables	95,000,000
Camp facilities	57,000,000
Subcontract for permanent office buildings	21,000,000
Subcontract for tankage	41,000,000
Transportation and handling of exported products	83,000,000
	$881,000,000

If we apply the percentages derived from our refinery example to the potential export market of $881 million, this translates into $290 million in lost exports from this project alone:

881 x .402 = $354 million
881 x .073 = 64 million
$290 million

In addition, this project will require approximately 6.8 million hours of home office direct and indirect labor. Assuming the home office work will take three years to complete, this project will result in 1,100 home office jobs here in the U.S. for the duration of the project.

Summary

Because the United States taxes its citizens working abroad, the U.S. contractor on our sample project will have additional field supervision labor costs of approximately $39 million. This puts the U.S. firm at a distinct competitive disadvantage vis a vis foreign firms whose supervisory employees are not subject to home country tax. If the project is awarded to a foreign firm, U.S. manufacturing and service firms stand to lose hundreds of millions of dollars of exports and the jobs arising from the U.S. home office's work are likely to be lost to the location of the foreign firm's home office.

We feel that each of the Senate bills now under consideration would go a long way towards eliminating the competitive imbalance caused by current law. However, in reviewing the relative merits of these bills we suggest that this committee should not only consider what is required to restore competitive equity for U.S. firms. In addition, the solution should be relatively simple and easy to administer. Current law (especially the section 911 "camp" provisions and the section 913 housing and home leave deductions) is so complex that few overseas workers are able to complete their returns without professional assistance. Furthermore "gray areas" in the law and regulations make it extremely difficult for U.S. firms to accurately estimate in advance their compensation costs on overseas projects. This also hinders U.S. firms' ability to submit firm competitive bids.

We appreciate the concern for thes problems which has been evidenced by this subcommittee's decision to hold these hearings and we stand ready to provide any information or assistance that may be required in resolving this most critical issue.

SUMMARY OF PRINCIPAL POINTS
IN STATEMENT

1. Field staff labor costs are a key cost factor in the award of overseas engineering and construction contracts.
2. Current U.S. tax laws add 25% or more to the staff labor costs of U.S. firms employing U.S. employees. These additional costs make it very difficult for U.S. firms to compete effectively with foreign firms whose employees pay no home country tax.
3. Loss of overseas contracts to foreign firms also results in the loss of substantial engineering work in the U.S. home office and potential loss of exports of additional products and services associated with the facility to be constructed.
4. Example - $1.8 billion Middle East process plant project:
    a. U.S. tax laws add $39 million to the cost of the project if U.S. field supervision is used. Use of U.K. rather than U.S. labor reduces the cost of the project by more than $63 million.
    b. The project creates an export market of $881 million for products and services other than services provided by the engineering and construction firm. Virtually all of this market is likely to be awarded to foreign firms if a foreign E&C firm is awarded the project.
    c. The project requires 6.8 million home office manhours, or 3,300 man/years. These jobs will be lost to the location of the foreign firm's home office if a foreign E&C firm is awarded the project.
5. What is needed is a legislative solution that will allow U.S. firms to compete on equal terms with foreign firms while eliminating the excess complexity of current law.

FLUOR

INTEROFFICE CORRESPONDENCE

To: L. M. FISHER

Location: Los Angeles

Date: August 23, 1977

Reference:

From: R. C. Lee

Location: Irvine

Client:

Subject: EXPORT OF U.S. MANUFACTURED EQUIPMENT AND MATERIALS BY U.S. CONTRACTORS

Per your recent request for an evaluation of the amount of U.S. manufactured goods purchased for export by U.S. Engineering and Construction firms vs. the amount purchased from the U.S. by foreign Engineering and Construction firms, I have a current example that illustrates the significant difference.

Project A and Project B are both grass roots petroleum refineries in the same country for the same owner

	Project A	Project B
Location	Same Country	
Owner	Same Govt Owned Oil Company	
Type Plant	Grass Roots Petroleum Refinery	
Type Contract	Lump Sum	Lump Sum
Financing	By Owner	By Owner
Engineer & Constructor	Italian	Fluor E&C
Status of Project	Near Completion	Eng. - 95% Constr. - 50%
Approx. Total Cost (1)	$400 Million	$800 Million
Total Imported Goods (FAS) (2)	$132 Million	$291 Million
Imported from U.S. (FAS) (2)	$9.6 Million	$117 Million
% From U.S.	7.3%	40.2%
Ocean Frt. (U.S. Bottoms) (3)	1.0 Million	11.5 Million

(1) Project B has twice the capacity of A.

(2) Information for Project A obtained from Client and thus details are confidential.

(3) Amount shown for foreign contractor is our estimate.

L. N. Fisher
Los Angeles

August 23, 1977
2

From this data, it appears that if Project B had been awarded to a foreign contractor, U.S. manufacturers sales would have dropped from $117 million to approximately $21.2 million or a loss of approximately $96 million. In addition, Fluor will spend approximately $10.5 million for ocean freight on U.S. Bottoms that would not be spent by a foreign contractor for a total loss to the U.S. of $106.5 million.

Dick
R. C. Lee

RCL:mc

EXHIBIT "B"

FLUOR

INTEROFFICE CORRESPONDENCE

AUG 17 1977
D. D. SEVERNS

To:	D. D. Severns	Date:	August 17, 1977
Location:	Irvine	Reference:	
From:	J. D. Krause	Client:	
Location:	Irvine	Subject:	Tax Survey

The following are responses of electrical Equipment manufacturers regarding the effect of loss of business of Fluor and similar companies in the world market.

Fifteen percent of General Electric Companys business is on overseas projects. Most of the equipment they manufacture can be purchased from foreign manufacturers. Loss of our type of business would result in reduction of force in many of their plants.

Gould did not have figures available for the percentage of business they do in the foreign market. They stated that loss of our type of business would be disastrous resulting in lay-offs and possible plant closures.

Westinghouse also did not have percentages available but felt that the effect would be considerable. It would cost many jobs including closure of the department headed by the person I was speaking with.

Thermo Electric has overseas plants. They could capture the business in these overseas plants but this would not help their domestic plants. Their domestic plants rely heavily on Fluor's and similar company's business.

J. D. Krause

FLUOR
INTEROFFICE CORRESPONDENCE

D. D. SEVERNS

Date: August 17, 1977

To: D.D. SEVERNS
Location: Irvine

Reference:

From: H.D. APPEL
Location: Irvine

Client:

Subject: SURVEY OF SUPPLIERS

Rotary equipment

cc: J.P. Bower

I have received the following responses from suppliers to the following questions:

A. What percentage of their U.S. factory business is from U.S. contractors versus non U.S. contractors?

B. What would be the affect if the U.S. contractors could not do overseas projects?

The responses have been as follows:

1. Elliott (Jeanette, PA) - Elliott's Jeanette factory workload is based on 60 - 70 % U.S. contractors. If those contractors could not do overseas projects, Elliott would suffer tremendously; maybe as much as 50% of the business would disappear.

2. Dresser Clark (Orlean, N.Y.) - Clark's Olean facility workload is approximately 60% based on U.S. contractors. If the U.S. contractors' business be eliminated, Dresser's business could drop as much as 40%.

3. General Electric (Schnectady, N.Y. and Fitchburg, Mass.) - G.E.'s gas and steam turbine business is basically 40% U.S. contractors and 90% on motors. If they were to lose the U.S. contractor source, business could drop off approximately 25%.

4. Dresser Pacific (Huntington Park, CA) - Pacific's workload is 70% based on U.S. contractors. Of that figure, 50% is for foreign projects. If that is eliminated, Pacific would lose approximately 35% of their business.

5. Turbodyne (Wellsville, N.Y.) - 70% of Trubodyne's factory workload is from U.S. contractors. A total loss of 25% of their business would occur if U.S. contractors could not do overseas jobs.

D.D. Severns

August 17, 197
Page 2

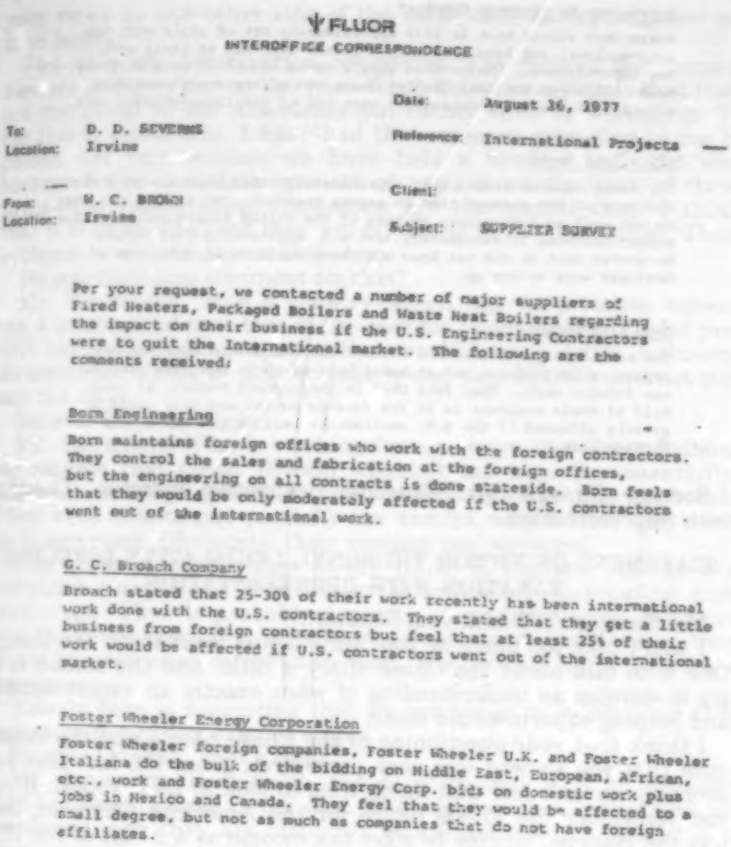
6. United Centrifugal Pumps (San Jose, CA and Houston, TX) - U.C.P.'s facilities are booked at about 70% by U.S. contractors. Since they are greatly involved in overseas work, they estimate a 60% drop in business if U.S. contractors can not bid overseas projects.

Please advise if more information is required.

Mike

Mike

MBA:lko



FLUOR
INTEROFFICE CORRESPONDENCE

Date: August 26, 1977

To: D. D. SEVERNS
Location: Irvine

Reference: International Projects

From: W. C. BROWN
Location: Irvine

Client:

Subject: SUPPLIER SURVEY

Per your request, we contacted a number of major suppliers of Fired Heaters, Packaged Boilers and Waste Heat Boilers regarding the impact on their business if the U.S. Engineering Contractors were to quit the International market. The following are the comments received:

Born Engineering

Born maintains foreign offices who work with the foreign contractors. They control the sales and fabrication at the foreign offices, but the engineering on all contracts is done stateside. Born feels that they would be only moderately affected if the U.S. contractors went out of the international work.

G. C. Broach Company

Broach stated that 25-30% of their work recently has been international work done with the U.S. contractors. They stated that they get a little business from foreign contractors but feel that at least 25% of their work would be affected if U.S. contractors went out of the international market.

Foster Wheeler Energy Corporation

Foster Wheeler foreign companies, Foster Wheeler U.K. and Foster Wheeler Italiana do the bulk of the bidding on Middle East, European, African, etc., work and Foster Wheeler Energy Corp. bids on domestic work plus jobs in Mexico and Canada. They feel that they would be affected to a small degree, but not as much as companies that do not have foreign affiliates.

Petro-Chem Development Company

Petro-Chem stated that in 1975 approximately 40% of their work was international and last year only a little over 20% of their work was international. Petro-Chem gets a small amount of work directly from companies but feel that at least 20% of their work would be affected if the U.S. contractors went out of the international work.

Tower Iron Works

The sales manager stated that approximately three quarters of their business at the present time is export business. He stated that they do not sell to contractors outside of the United States and this this export business is exclusively with U.S. engineering contractors. He stated that he did not know what they would do if this type of business were to dry up.

John Zink Company

The sales manager stated the bulk of their domestic work has been repair or replacement and at least half of their business last year was foreign work. They feel that in the present market, at least half of their business is in the foreign market and they would be greatly affected if the U.S. contractors were to get out of the foreign work.

Senator CHAFEE. Mr. Thuronyi, legislative director, Taxation with Representation.

STATEMENT OF VICTOR THURONYI, LEGISLATIVE DIRECTOR, TAXATION WITH REPRESENTATION

Mr. THURONYI. Thank you, Senator.

I won't take too much of your time. I just want to do two things. One is to talk about the Chase study a little, and the second is to try to develop an understanding of what exactly an export subsidy and helping exports would mean.

I think that your questioning of the Chase people and the skepticism that you showed was very perceptive, given the fact that you probably haven't had that much time to look at their report. If you just remember the $7,800 figure for the American Chamber, that was the reported change in after tax income as a result of the 1978 act. It was a change from the pre-1976 law to the 1978 law.

Now, the Treasury Department estimated that the additional revenue loss from the change from the pre-1976 law to the 1978 act is around $180 million. There were about 179,000 returns filed claiming section 911 or 913 exemptions. That works out to just about $1,000 per taxpayer, and here we have figures ranging from $3,600 to $7,800.

I think that what this demonstrates is the results that you get when you conduct a survey about whether tax law ought to be changed and you ask the people that stand to get the tax breaks. It is not very surprising that people put the best possible case about the change in their after tax income. The same thing happens when you ask people, well, how much business do you think you will lose, how many exports do you think you will lose?

Well, when people are asked the question, they can make a high estimate.

Senator CHAFEE. Well, I'll tell you that I don't really want to debate the Chase study now, because it is incredibly complex and we are running short of time. What I would be interested in here is your views on the other side of the issue, that is, the evidence we have heard.

Just take the construction companies. The construction companies are going to bid on the jobs. What they are saying is that they are not going to use Americans but rather Brits or whomever. To me this is disturbing. I have had this evidence presented to me in person not just because we have held a hearing here but also because I feel a certain amount of anguish on the part of these firms—the construction companies are the easiest case. I think that it is quite clear cut they are not going to use Americans. Their evidence is unanimous on this score.

Do you have any comment on that?

Mr. THURONYI. Take a country which has no personal income tax. I understand that that is the case for Saudi Arabia. Under pre-1976 law, and under proposals that would have a dollar exclusion, an employee would be able to take home, say, $50,000, and not pay any tax on it.

Senator CHAFEE. Right.

Mr. THURONYI. If he is working for a country like Great Britain, we assume that Great Britain wouldn't tax him. So, essentially, what you are saying is that these constructors had this tax break. They were able to pay partially tax exempt wages. Now they can't do it any more. Obviously, their position has worsened.

The question that comes to my mind is, suppose you have a computer company in New Jersey or somewhere supporting high technology. That is probably a pretty competitive area. Why not give them the possibility of paying tax exempt wages? I mean, they would become more competitive then. The product has a high labor component.

Nobody here is suggesting that we are going to be allowing U.S. exporters to pay tax exempt wages.

Senator CHAFEE. That's right.

Mr. THURONYI. Essentially, the point is that it is an industry that has been favored in the past. They are now losing that favored treatment, and they are obviously concerned about it, and it is a dislocation that they will have to suffer.

Senator CHAFEE. Yes, that's right, but the question is whether we all suffer in some way because of it. In other words, we have policies in the United States in which we take certain actions because they enhance for the general welfare. So, what we are considering here is whether there is enough good for all involved by making this tax change.

If it will produce more jobs from orders coming back to Pawtucket, Rhode Island, or Chambersburg, or wherever for a modest loss in revenue, it is a good investment. Likewise every city in the country gives tax relief to plants when they come there. The new plant gets a break.

Mr. THURONYI. I agree with that, Senator.

Senator CHAFEE. The reason for this policy is that it is for the community's good. We think it is worthwhile.

Mr. THURONYI. Yes. The theory there is that you have, say, one engineer in Saudi Arabia, and that engineer is writing orders that go out to various U.S. companies. If the U.S. companies were able to get together, and these orders, let's assume, are far in excess of the equalization payment that the engineer would have to get, if these U.S. companies were able to get together, and if there is such a big impact, such a big increase in orders, then it would be in their interest to pay the equalization payment.

What the U.S. companies are essentially saying is, well, it is impossible under a free market to get together and do this sort of thing, and it probably would violate the antitrust laws. Instead of us getting together and paying this guy's equalization payment, we want the U.S. Government to do it.

Senator CHAFEE. The U.S. Government is not an invisible thing. The U.S. Government collects its money from a whole series of places. The person who gets the order contributes to this for he pays a 46-percent tax on every dollar he makes.

Mr. THURONYI. Well, in my prepared testimony, Senator, I suggest that if U.S. exporters are really getting as large benefits as they have claimed in surveys, they would be willing—they should be willing to get together and pay a small tax to be put into a trust fund, and then have that be used for targeted tax breaks to those employees that really do increase the orders of the exporters.

The point is, that those exporters are essentially asking the Treasury to pay their sales costs, and I think it might be appropriate to do so if those costs were paid by the exporter in the form of a very small income tax on the income from exporting. It could be limited—I was told that 85 percent of our manufactured exports are produced by 1,900 companies. So, the tax could be limited to those large companies. It would be on the order of 1 percent of income. That tax would then be used to pay the sales costs.

Senator CHAFEE. Well, that is a possibility. Of course, I suppose you could apply the same thing. The Department of Commerce has foreign trade representatives around the world scurrying around on the Federal Government payroll to get orders. Now, I suppose under your theory you would say those orders, 85 percent of them going to 1,800 companies, is unfair to you and me, as ordinary taxpayers who get nothing out of this, to have some of our taxes go to pay these Commerce Department——

Mr. THURONYI. It is not unfair, Senator. It is just slightly inefficient. The question is how large a revenue loss do we have from the Commerce Department people. It probably is not as large as the kind of revenues we are talking about here, because those people are specifically targeted to U.S. exports.

I think that people who are going to be increasing good will of foreign people in favor of U.S. products as some other countries do, that might be a good thing, because it is efficient, and you know, it is specifically tailored, but here we are talking about tax breaks for people who have nothing to do with promoting U.S. exports. I think that may be excessive.

Senator CHAFEE. Of course, that is the point. I reject your assumption that Americans have nothing to do with promoting U.S. exports. I think they do. That is the argument here. We are not solely discussing having Americans abroad just because we will have more Americans employed. That is one point. We are also saying that having these people overseas in various positions is good for the business of the Nation, setting aside the intangibles that I talked about before, which you might have heard.

best copy available

We believe they encourage exports. Now, Chase goes quite far on what they predict, but I think you heard the testimony of Mr. Dickey and others, what it means.

Well, we have your testimony. Is there anything further you would like to add to it right now?

Mr. Thuronyi. No, I think not.

Senator Chafee. I don't want to cut you off.

Mr. Thuronyi. No, that is all I have.

Senator Chafee. Fine. Thank you very much for coming, Mr. Thuronyi. We appreciate it.

Mr. Thuronyi. Thank you very much, Senator.

[The prepared statement of Mr. Thuronyi follows:]

TWR

TAXATION WITH REPRESENTATION
A Public Interest Taxpayers' Lobby

6830 North Fairfax Drive, Arlington, Virginia 22213 (703) 532-1850

WASHINGTON OFFICE
Suite 204, 1523 L St., N.W.
Washington, D.C. 20005

Statement of Victor Thuronyi

Legislative Director, Taxation with Representation

Before the

Subcommittee on Taxation and Debt Management
of the
Senate Finance Committee

June 26, 1980

regarding

Taxation of Foreign Earned Income

The U.S. tax law provides generous treatment to Americans abroad. The current special provisions lose about half a billion dollars per year, and an additional half a billion would be lost by complete exemption of foreign earned income.

The current provisions were enacted in 1978. They replaced the previous $20,000 exclusion with a set of deductions designed to give relief to persons experiencing high living costs abroad. The old $20,000 exclusion benefitted those living in countries with no income tax. These persons had to pay no tax to any country on the excluded earnings. Understandably, they are upset at the removal of their tax-favored treatment, and they are arguing that it should be restored.

Their principal argument is not that a dollar exclusion is necessary as a matter of fairness, but rather that tax exemption is required in order for Americans to be able to compete with firms operating abroad employing third-country nationals who do not have to pay tax to their home country. They also argue that Americans overseas make a vital contribution to selling U.S. exports and that therefore the U.S. government should be willing to foot the bill.

The debate has been going on for a long time. The latest item is a study by Chase Econometrics prepared for The U.S. and Overseas Tax Fairness Committee. The Tax Fairness Committee's members are 28 construction companies with extensive operations overseas. They paid the Committee some $108,000 in the first quarter of 1980 alone to conduct its effort to persuade Congress to give them tax breaks. There is nothing reprehensible about this; I mention it just to identify the parties in interest.

The Chase study concludes, among other things, that the U.S. Treasury would actually gain revenue if all foreign earned income were made tax exempt. Unfortunately, the study provides no evidence for this and other assertions. An analysis of the study's failings is appended to this statement.

Nevertheless, tax help for exports may be justified. If the effect of overseas Americans on exports is as great as the proponents of tax relief suggest, exporters should be willing to get together to foot the relatively small bill. I suggest that the appropriate way of financing the sales effort of the export segment of U.S. industry is to impose a one percent tax on the net income from nonagricultural exports. The tax proceeds would go into a trust fund to be used to give tax breaks to overseas Americans. These tax breaks should probably not go to everyone, only to those employees attracting U.S. exports. It may be appropriate to give the tax subsidy to the employers, rather than the employees, since the purpose of the subsidy is to reduce the cost of hiring overseas workers, not to give special favors to the workers themselves.

If U.S. exporters are not supportive of the trust fund concept, I suggest a reexamination of the justifiability of the United States government going into a business that private businesses think is not worthwhile.

Quite apart from the desirability of giving blanket relief through a trust fund or through measures such as S. 2283, 2321, and 2418, I think it would be appropriate to think about ways of more carefully tailoring and simplifying current sections 911 and 913. In addition, the foreign tax credit provisions discriminate against taxpayers living in countries with a high level of indirect taxation. Thought should be given to extending the foreign tax credit to all taxes paid to foreign governments, with taxes such as the value-added tax computed as a percentage of income or expenditure. This sort of revision of the foreign tax credit provisions should be made so as not to affect the current rules governing the creditability of taxes paid by corporations and businesses, which present separate problems.

SPECIAL REPORT

A CRITIQUE OF THE CHASE STUDY OF THE TAX TREATMENT OF U.S. WORKERS OVERSEAS

by Victor Thuronyi

Victor Thuronyi is legislative director of Taxation with Representation, a taxpayer's lobby. In this article, he critiques the findings of a recently released report prepared by Chase Econometric Associates, Inc., entitled "Economic Impact of Changing Taxation of U.S. Workers Overseas." The Chase report, which was summarized in last week's Tax Notes (see page 976), is available through the Tax Notes Complete Access Service as Doc 80-4080. Alternatively, it may be ordered from Chase Econometric Associates, Inc., 900 17th Street, N.W., Washington, D.C. 20006.

In this article, Thuronyi criticizes the Chase report for raising, but failing to analyze, the principal equity questions relating to the tax treatment of Americans working overseas. He is sharply critical of Chase's use of hypothetical export figures as the basis for its computer modeling and policy conclusions. He is also critical of the Chase model's failure to take floating exchange rates into account, and of Chase's use of seemingly overstated export dollar magnitudes.

Thuronyi then analyzes a variety of other claims made in the Chase report, including the assertions that Americans are returning from overseas due to increases in U.S. taxes and that U.S. exports are being reduced by the absence of U.S. workers overseas. He finds the evidence for the first assertion supplied by Chase to be shaky at best, and notes that economic theory suggests that the recent tax changes with respect to overseas workers may actually increase exports, rather than decrease them.

Thuronyi concludes his article with an examination of alternative forms of export subsidies. In particular, he suggests that, if the claims in the Chase study are taken at face value, U.S. exporters should be glad to pay a small added tax to fund expanded tax breaks for U.S. citizens working overseas.

As a result of changes in the tax law since 1975, U.S. citizens working overseas will pay approximately $180 million more in taxes in 1980 than they would have paid if the law had remained unchanged.[1] A recent report prepared by Chase Econometric Associates, Inc. on behalf of the U.S. and Overseas Tax Fairness Committee, which represents 28 construction firms, claims that this additional tax burden resulted in a drop of about five percent in U.S. exports. If this claim is true, a further exclusion of foreign earned income, for the purpose of stimulating exports, may be warranted.

This article evaluates the soundness of the Chase report on the taxation of U.S. workers overseas. My analysis of the report suggests that its claims are largely unsubstantiated. If this report is the best evidence that can be produced to support special tax treatment for foreign earned income, then a case for further relief has not been made.

However, the inadequacy of this particular study does not mean that government assistance in this area is necessarily unwarranted. The need for assistance must be developed through further study. Any study of this sort should also consider which of the following would be the most efficient way of spending government funds to stimulate exports: a tax subsidy for employees, a tax subsidy for employers, or direct expenditures. In addition, ways of targeting tax expenditures on the goal of expanding U.S. exports need to be explored.

The Chase study consists of two parts. The first deals with the "equity" of changes in the tax law that impose higher taxes on U.S. citizens abroad. The second deals with the effect of the tax law on economic variables and criticizes the Treasury's estimated revenue loss from the special treatment accorded (or proposed to be accorded) these taxpayers.

Chase's Discussion of Tax Equity

Once the decision has been made to tax U.S. citizens who live abroad, it is reasonable to treat equally taxpayers in the U.S. and abroad with the same income, with an allowance for differences in circumstances when circumstances are different. Under this criterion, a taxpayer should not generally be able to improve his tax position by moving abroad.

Current law seeks to achieve equitable treatment of this sort. The product of intensive debate since 1976, sections 911 and 913 allow for exclusion of amounts

All that the Chase study does is to run an assumed number through a computer model to see what the economy would be like if a hypothetical drop in exports were to occur.

---

[1] The exclusion of income earned abroad by U.S. citizens is estimated to cost $446 million in lost revenue in calendar 1980. This revenue loss is slightly less than the $627 million revenue loss that would have taken place in calendar 1980 if pre-1976 law had still been in effect. The difference between these two figures is $181 million.

from gross income in some cases, and further allow foreign residents to take deductions for the excess cost of living abroad. While the new provisions are not perfect, and seem unnecessarily complex in some cases, they seek to achieve the goal of tax equity, by denying favored treatment to taxpayers who experience no adversity in being taxed at U.S. rates.

Because the law prior to 1976 did not distinguish between high-cost and low-cost countries, it favored taxpayers who lived in low-cost or low-tax countries. These persons were allowed to exclude a dollar amount from income even if they suffered no additional living costs, and even if they paid no taxes to the foreign country in which they were living. From the point of view of tax equity, the 1978 revision was an appropriate change insofar as it denied favored treatment to these persons.

The Chase study seems to disagree. It asserts (at page 13): "the impact of recent tax changes is predictably concentrated among Americans in low-tax countries who have either very low or very high levels of allowances and whose employers do not compensate them for the increased taxes. This raises serious problems of equity among U.S. workers in different parts of the world."

But all that Chase states is that, in correcting for the anomalies of pre-1976 law, the 1978 Act made worse off those persons who stood to benefit from pre-1978 treatment. What the study *does not* discuss is whether pre-'76 or post-'78 treatment is fairer. It just says that the 1978 change in the law affected different people differently — as it should have — but does not say whether the current tax treatment is appropriate and, if not, how it should be changed.

Moreover, the numerical examples employed by the Chase study are not very useful, because they are just that — examples. Without any data backing up the proposition that these examples have any relation to actual experience, the examples are just as relevant as counterexamples that may lead to results opposite from those sought to be advanced by the Tax Fairness Committee. The bottom line is that the study provides *no evidence* for the assertion that the 1978 change in the law "raises serious problems of equity" — indeed, the study does not tell us what these serious problems are.

Chase's Discussion of the Economic Variables

The second part of the Chase study is concerned with providing a basis for the argument that favorable treatment of U.S. persons overseas, even if it cannot be justified on grounds of tax equity, is compelled by economic reality.

The study does not . . . evaluate the soundness of the claim that our current tax rules cause a decrease in exports. Thus, the Chase study fails to provide any evidence about the very question to which it was presumably addressed.

The first thing this section does is to review the results of a survey of those persons seeking to change the law. The survey was taken of two groups: members of the National Constructors Association, which has overlapping membership with the Tax Fairness Committee, and members of the American Chambers of Commerce Overseas in 42 countries. The survey asked the respondents to estimate how much the change in the law cost them, and what effect this increase in costs had on their sales.

If this report is the best evidence that can be produced to support special tax treatment for foreign earned income, then a case for further relief has not been made.

The Chase study reports the results of the survey, but does nothing more with them, recognizing that they are nearly valueless. This is because the survey is a case of asking the fox to guard the chicken coop. The respondents knew full well what the survey was setting out to do, and their responses were clearly biased in the direction of exaggerating the burden placed on them and overestimating any drop in their sales. The magnitudes reported are truly incredible, and one can only wonder that Chase reports them without a qualifying comment as to their bias.

Chase does note that "the exact magnitude of lost business is very difficult to determine," but this qualification would be required even if the estimates given in the survey were completely unbiased, since no means is provided of extrapolating from the survey responses to obtain an aggregate figure for all U.S. exports. The sample chosen is not a random one, and it would thus be an illegitimate statistical exercise, quite apart from any bias, to asume that the sample was representative of the experience of U.S. export business as a whole. Indeed, the survey of the Constructors which was most heavily relied on by Chase was concededly limited to one industry and is thus of questionable usefulness in tracking total U.S. experience.

The next part of Chase's exercise is to produce some numbers that look plausible for the United States as a whole. After all, an argument that U.S. exports will fall five percent and that something therefore needs to be done sounds a lot more compelling than a claim that 28 construction firms are losing work because of changes in the tax laws and should therefore be bailed out.

Figures from the Dartboard

Where does Chase get its figure of a five percent decline in exports? (Report, p. 33.) Apparently from the dartboard. Chase states:

> The evidence from our surveys and from prior studies indicates that the reduction in exports is on the order of 5 percent. We will therefore use that as the starting point for our analysis, acknowledging that the number could be either somewhat higher or lower.

In other words, Chase offers *no evidence* to justify its claim that U.S. exports are reduced "on the order of 5 percent" by our current tax rules with respect to overseas Americans. There is *nothing* in its report to show how particular "studies" make a five percent drop in exports reasonable, rather than zero percent, a negative percentage, or some other figure.

In short, the five percent export drop hypothesized by the Chase report is completely *made up*. All that the Chase study does is to run an assumed number through a computer model to see what the economy would be like if a hypothetical drop in exports were to occur. The study does not, however, evaluate the soundness of the claim that our current tax rules cause a decrease in exports. Thus, the Chase study fails to provide any evidence about the very question to which it was presumably addressed.

Because the law prior to 1976 did not distinguish between high-cost and low-cost countries, it favored taxpayers who lived in low-cost, low-tax countries.

We don't, however, need a fancy computer model to evaluate the likely results of a decline in U.S. exports. Macroeconomic theory says that exports, like government expenditures or investment expenditures, can be considered an exogenous factor which has the potential of stimulating or depressing the economy. Thus, a fall in exports, just like a decline in government spending, leads to more unemployment. Obviously, at the resulting lower level of economic activity, government receipts are lower and outlays such as unemployment compensation are higher.

The Chase figures show quite a large decline in tax receipts resulting from the assumed five percent export decline, which is not surprising. Chase then asserts: "Thus, the lost tax receipts from reduced exports are many times greater than the taxes paid by overseas workers." (See page 33.) This statement is very misleading, because it fails to acknowledge that one figure being compared — the revenue cost of favored treatment of U.S. citizens abroad — is a reasonably solid one, developed by Treasury, while the other — the decline in revenue due to the five percent drop in exports — is, as noted before, *made up*. The assumed figure may sound more plausible, because it happens to be a figure that was churned out by an economic model. How much less plausible to assert: "Let's assume that revenues decline by $7 billion, due to a decline in economic activity from a plausible decline in exports. This $7 billion revenue loss would be greater than the $500 million revenue loss from exempting overseas workers from tax." Such a statement would be patently worthless, but it is essentially equivalent to what Chase has done, stripped of its econometric trappings.

Model Fails to Take Floating Rates Into Account

Perhaps even more disturbingly, the economic assumptions inherent in Chase's use of its model are incorrect. Chase, as noted before, assumes that exports of firms with U.S. workers abroad, plus exports attracted by those workers from other firms, go down to such an extent that total U.S. exports decline by five percent. But let us ask ourselves what would happen in the real world if this were to take place? In that case, the value of the dollar would fall somewhat until exports and imports were equalized. Thus, other exports would rise somewhat and imports would fall.

The point is that with relatively free-floating exchange rates, one need be less concerned with maintaining "competitiveness" by granting export subsidies than one would be in a world of fixed rates. Tax-favored treatment of foreign residents as a means of increasing exports is functionally equivalent to an export subsidy.

A tax subsidy, in a world of floating rates, will have the effect of pushing up the exchange rate and therefore making non-subsidized exports more expensive and imports cheaper. Thus, the principal effect of the tax subsidy will be to expand employment in the industries represented by the Tax Fairness Committee, but to decrease employment in other export industries and in U.S. industries that compete with imports. The Chase study does not go into these qualifications. By failing to do so, it is seriously misleading.

Dollar Magnitudes are Dubious

Quite apart from the lack of data supporting the five percent figure Chase uses, the dollar magnitude of the assumed five percent decline — $16.2 billion according to the Chase study — seems to be overstated. A $16.2 billion decline assumes a base of $324 billion. But total nonagricultural exports were only $144 billion in 1979. It is quite unlikely that U.S. employees abroad stimulate much demand for exports such as agricultural goods. If the $144 billion is used as a base, Chase's $16.2 billion figure should be revised downward to about $7 billion. Needless to say, the figure remains just a speculation.

Assertions Without Evidence

Chase acknowledges that its study really offers no reliable proof, but asserts (Report, p. 32) that this lack of data does not detract from the validity of the following "basic points, supported by economic theory, survey results and prior studies:

- increased taxation reduces the attractiveness of overseas employment and the supply of workers to fill such jobs
- exports are reduced by the reduction in U.S. workers overseas."

The first point made by Chase — that an increased tax burden on citizens overseas will lead to a decline in overseas employment — is correct. However, Chase's quantification of this decline seems misleading. The "Executive Summary" of the Chase study states as one of the "principal findings" of the study that "A high percentage of U.S. workers abroad — in some cases as high as 50% or more — are voluntarily and involuntarily returning to the U.S. because of the tax."

The study does not discuss . . . whether pre-'76 or post-'78 treatment is fairer. It just says that the 1978 change in the law affected different people differently — as it should have . . . .

But the body of the study provides no basis for the assertion that a "high percentage of U.S. workers abroad" is returning home. At pages 21-22, the study reports the result of a survey of construction firms, which, as noted above, are interested parties with regard to the question at issue. These firms claimed that 56 percent of their overseas employees returned from abroad.

Apparently, this is the only evidence in support of the conclusion that a "high percentage" of workers is returning to the U.S. Extrapolation from the 56% figure is, however, quite unwarranted. First, there is the bias problem. The respondents had an interest in overstating the number of workers coming home, because they knew that would make the study look better.

Second, there is the statistical problem that the sample is not random and is quite small. Third, the sample appears to be unrepresentative. In particular, it seems to be heavily weighted towards employees in low-tax countries, like Saudi Arabia, who concededly feel the heaviest impact from the 1978 tax change.

For example, the Chase study asserts that "The after-tax income of U.S. workers overseas is substantially reduced, unless employers provide equalization. For construction workers, the loss averages $3800; for other workers the loss averages about $7800." Yet as noted earlier, the aggregate revenue gain from the recent tax changes with respect to overseas Americans is about $180 million, while the number of overseas taxpayers claiming some sort of deduction or exemption in 1978 was about 178,000. That works out to an average revenue gain on the order of $1,000 per taxpayer — a substantial difference from the Chase figures. This indicates that the Chase surveys were based on rather unrepresentative samples.

The bottom line is that the study provides no evidence for the assertion that the 1978 change in the law "raises serious problems of equity" — indeed, the study does not tell us what these serious problems are.

Persons in high-cost, high-tax countries may actually be *better off* as a result of the recent U.S. tax changes. Without information as to the breakdown of citizens overseas among high-tax and low-tax countries, it is impossible to estimate the effects of the tax change. It is certainly misleading to imply that the claimed experience of the Chase survey respondents provides a reasonable basis for an aggregate estimate.

Three Omitted Economic Factors

The second "basic point" of the Chase study is that "exports are reduced by the reduction in U.S. workers overseas." This point is said to be supported by "economic theory, survey results and prior studies." We have already shown that survey results provide a rather poor basis for this assertion.

As far as economic theory is concerned, there are three factors that Chase ignores which make it possible for the tax *increase* to actually cause an *increase* in exports. The first is that, while some citizens abroad no doubt promote sales of U.S. goods, others help to manufacture goods produced by subsidiaries or branches of U.S. corporations, and those goods may be a direct substitute for domestic goods whose production results in domestic employment.

For example, a U.S. corporation with substantial export sales can often reap tax and other benefits by organizing a foreign subsidiary, to which manufacturing know-how is transferred. A few U.S. citizens may be employed abroad to supervise the foreign workers in their manufacture of the product. In taking this step, which involves the employment of some U.S. citizens abroad, a company may cause a net reduction in U.S. exports. If this sort of operation outweighs the kind of operation in which U.S. workers abroad contribute to U.S. exports, the net effect of discouraging foreign employment of U.S. citizens may well be to increase, rather than decrease, exports.

Chase's claim to the contrary, economic theory does not provide an answer to questions of this sort, which obviously must be derived from empirical research looking at the global experience of U.S. multinational corporations and U.S. exporters. A survey of overseas construction workers simply will not do.

The second factor apparently neglected by Chase is that U.S. workers abroad eat, send their children to schools and pay rent (rather expensive items in many cases) and in doing so reduce the net amount of foreign exchange brought back into the U.S. on their return. How Chase treats this item is not clear. However, this factor must be taken into account in quantifying the net increase in exports due to presence of citizens overseas.

The third theoretical point seemingly overlooked by Chase is the effect of an increase in the price of exports (because of increasing costs due to higher taxes on employees) on the dollar amount of sales. Even if the volume of sales declines, it is quite possible, depending on the relevant demand elasticity, for the amount of exports expressed in dollars (which is presumably the relevant figure) to go up. An elasticity equal to one, for example, would imply that an increase in price of a given amount would lead to an equiproportionate decline in demand, so that the price increase's effect in increasing exports is exactly balanced. Thus, careful microeconomic work in estimating price elasticities is required before estimates of changes in exports can be made. The Chase study does not attempt to estimate price elasticities for exports, and, in stating that "economic theory" indicates that exports necessarily decline when taxes on overseas workers go up, the study is therefore misleading.

Chase's Criticism of Treasury's Revenue Estimates

A 1978 Treasury Department study calculated that $499 million in additional revenue would be gained if the section 911 exclusion, as effective just before the 1978 change, were eliminated. Chase asserts, however, that "a careful analysis indicates that the overall impact of the law is to reduce total U.S. income and hence to reduce tax revenue." (Report, page 30.)

According to Chase, the Treasury estimates are wrong for several reasons. First, since 30 percent of taxpayers affected by the overseas tax provisions could be expected to return home if preferential treatment were completely eliminated, the revenue loss estimate should first be cut by 30 percent, to $350 million. Second, assuming that firms pay their employees an additional $350 million to compensate them for the tax change, corporate taxable income will decline by $350 million, leading to a $161 million decline in corporate tax revenues (at a 46% corporate tax rate). This analysis is incorrect, for several reasons.

First, Chase does not indicate how it arrived at the 30 percent figure for citizens returning home if tax preference were eliminated. One must assume that this is again a made-up number.

The Chase survey . . . is a case of asking the fox to guard the chicken coop. The respondents knew full well what the survey was setting out to do . . . .

Second, it is not legitimate to assume, as Chase seems to do, that these workers would come home to be unemployed. At present, these workers are purchasing goods in the foreign country where they reside. When they return home, they will raise the aggregate level of effective demand and thus lead to an expansion in total U.S. employment. Of course, they will have to pay taxes. Thus, revenues should be unaffected by the workers' return home.

Third, as far as increased compensation to workers abroad is concerned, Chase neglects to mention that the increased payments will lead to an increase in taxable income and hence in revenues.[2] On the deduction side, however, it is not likely that the increased payments to overseas Americans would cause much of a decline in U.S. tax revenues. If the foreign country has corporate income tax rates comparable to ours and if the U.S. corporation operates through a branch, then the U.S. corporation will not be paying any U.S. tax on its foreign income, because it will be entitled to a foreign tax credit. If taxable income is reduced because of the equalization payment, then the foreign country will collect less tax from the corporation (which it may to some extent recoup through increased taxes on the employee).

On the other hand, if the foreign country has a low corporate tax rate, then most U.S. corporations can be expected to operate through subsidiaries, so as to enjoy the benefits of U.S. tax deferral. In this case, the equalization payments by the subsidiary will not lead to any revenue loss to the U.S., because the subsidiary is in any case not liable for U.S. tax. Only in the atypical case of a U.S. corporation operating through a branch in a low-corporate-tax foreign country will the equalization payment lead to a decline in U.S. corporate tax revenues. But, unless the country also has high personal tax rates, this revenue should largely be made up by increased liability on the part of the employee. On balance, equalization payments by employers would probably lead to an increase, rather than a decrease, in U.S. revenue.

In sum, three flaws in Chase's argument negate its attempted criticism of Treasury's revenue estimates.

Is a Tax Subsidy Warranted?

Three bills currently under consideration in the Senate, S. 2283, 2321 and 2418, would expand special treatment of foreign earned income.[3] This analysis has shown that the Chase study, which attempts to provide an underpinning for this special treatment, fails in doing so. One wonders whether there can be a very strong case for favored treatment if this is the best evidence that the persons who most stand to gain can come up with. Nevertheless, Chase's failure does not negate the possibility that it may be in the national interest to provide a subsidy to foreign workers as a means of making our exports more competitive.

There are two principal arguments in favor of a tax subsidy. The first is concerned with those sales for which the employment of U.S. citizens overseas is a direct cost of the product. An example is provided by a construction company that intends to employ U.S. workers to build a plant. If the tax burden on employees goes up, and if the company has a policy of protecting the employee from the tax increase, labor costs will go up. As a result, the company may be outbid by competition which employs third country nationals who do not have to pay income tax to their home countries.

Labor costs are a part of doing business for all exporters, and exporters which manufacture in the United States do not have the privilege of being allowed to pay tax-exempt wages. As an initial matter, it does not seem that companies manufacturing outside the United States should be accorded this privilege. But if the demand for the particular good or service provided is especially elastic, it may be warranted to give a subsidy to that product. The theory is that, at a relatively small cost, sales of certain goods can be greatly expanded.

Chase offers no evidence to justify its claim that U.S. exports are reduced "on the order of 5 percent" by our current tax rules with respect to overseas Americans.

The alternative would be a downward adjustment in the exchange rate. But, since such a downward adjustment would change the prices of *all* exports and imports, some of which may be less elastically demanded, the exchange rate is a crude and undesirable

---

[2] Of course, if the employee is subject to foreign income tax, then some of this revenue will go to the foreign, rather than the U.S. Treasury. But one is mostly concerned here with low-tax foreign countries.

[3] S. 2283, introduced by Senator John H. Chafee, R-R.I., would provide a $50,000 exclusion for foreign earned income, increasing to $65,000 if resident abroad for three years. Section 913 would be repealed, but a deduction for housing costs or a reasonable housing allowance in excess of 20 percent of earned income would be provided. S. 2321, introduced by Senator Roger W. Jepsen, R-Iowa, would repeal section 913 and exclude all foreign earned income in the case of bona fide residents for a full year or persons present in foreign countries for 17 of 18 months. S. 2418, introduced by Senator Lloyd Bentsen, D-Tex., would provide a $60,000 exclusion for foreign earned income for persons resident for a year or present for 11 of 12 months. Section 119 would be amended to exclude lodging in camps (now covered in section 911) from income. Finally, section 913 is modified so as to deal only with housing expenses. The new provision is essentially the same as the current housing expense deduction, except that the nondeductible amount of expense is a dollar amount rather than being related to the taxpayer's income and deductions, as under current law.

With relatively free-floating exchange rates, one need be less concerned with maintaining "competitiveness" by granting export subsidies . . . .

means of achieving foreign trade equilibrium. The crucial qualification is that subsidy would be warranted under this theory only if the elasticity of demand (ignoring for simplicity the relative supply elasticities) for the subsidized good exceeded the average elasticity for U.S. exports. This has to be shown by econometric work.

Having argued that the tax relief sought might be justified as a way of subsidizing exports, I am led to wonder why the advocates of relief do not suggest an outright ad valorem subsidy, rather than a subsidy to labor costs. After all, if it is an export subsidy that is called for, it would seem most appropriate to give relief to all costs of production, not just labor, within whatever restraints are imposed by GATT.

Subsidizing Salesmen

The second argument in favor of a tax subsidy is that the presence of certain employees overseas may lead to additional U.S. export orders, perhaps far out of proportion to the particular worker's salary. For example, if a pipeline construction company employs a British engineer, who has occasion to order an engine to pump gas through the pipeline, he may be more familiar with the British companies that manufacture this sort of engine, and order through them. Conversely, if an American were employed in that position, the engine would likely be ordered from an American company with which that employee felt familiar. If the tax laws discourage employment of the American, then the pipeline company would be likely to employ the U.K. citizen instead, since the U.K. does not tax its citizens on foreign earned income. As a result, the U.S. engine manufacturer would suffer a loss in sales to its U.K. competition.

If the U.S. engine manufacturer were aware of the situation, it might be worth its while to defray the pipeline company's additional cost of employing the engineer overseas. That would put the pipeline company in as good a position as it would have been, and it would increase the sales of the engine manufacturer at a relatively small cost to it (supposing that the contract is worth much more than the engineer's additional salary). The trouble is that it may be impossible for the engine company to find out about the problem and to limit its cost to the one engineer's salary. Further, there may be many other companies providing potential custom to this engineer, with each of them willing to pay only a part of the additional salary. Finally, some of these U.S. companies standing to benefit from the presence abroad of persons such as our engineer may be content to stand by while other exporters foot the bill — what is known as a "free rider" problem.

In short, it may be very unlikely that U.S. exporters will get together and foot the bill for Americans abroad, even if it were in their interest to do so if agreement could be feasibly reached. To some extent there is such cooperation, in the form of American Chambers of Commerce overseas and like organizations. In addition, the U.S. government provides some help to U.S. exporters through its embassy and consular staffs. The question presented here is whether additional help to U.S. exporters in marketing their goods should be provided through the tax system.

As a matter of economic theory, there is no obvious answer to this question. One would want better data, preferably in the form of time series analysis of the effect that U.S. persons abroad have on exports. The two-way causation between exports and Americans abroad makes econometric analysis of this question difficult, however.

Alternative Forms of Export Subsidy

Any government money earmarked to promote exports must be spent wisely. There are several alternative approaches to the problems addressed by S. 2283, 2321 and 2418 that should be explored. For example, the tax incentive could be given to the *employer* instead of to the employee. This would approximate the effect of an exporter's reimbursement of the equalization payment.

Such an approach may also be more desirable from a tax equity point of view than giving the benefit to the employee. In the case of companies that employ a "tax equalization" method of setting the salary of employees overseas, it would make no difference, because under the tax equalization method any lower tax liability on the part of the employee would immediately result in lower salary. Under the "tax protection" method, however, an employee receives an additional payment if his tax situation worsens on a move overseas, but if the employee's position is improved, the employee is allowed to retain the benefits. It would thus be inequitable in some cases to give special benefits in the name of incentives to employees paid under a tax protection system, since the employee would retain the benefits of the tax subsidy. Structuring the subsidy to go to the corporation would avoid this problem.

Taking Chase at Its Word

In order more closely to approximate the effect of cooperative payment of salary additions by exporters, consideration should also be given to payment of the tax break out of a trust fund collected from U.S. manufacturing exporters. If a subsidy has a dramatic effect on exports — as Chase and others claim — those companies should be quite willing to foot the relatively small bill. For example, if it were desired to increase individual tax breaks for overseas workers from $446 million to $600 million, a net income tax of about one percent on the income from nonagricultural exports would suffice. The trust fund approach would also have the advantage that the companies paying the bill would keep close watch to insure efficient use of the revenues.

READER COMMENTS WELCOMED

We'd like to publish reader comments on this article in our "Letters to the Editor" column. If you'd like to make your views known, please write us promptly.

Please note that letters must be signed, and that we reserve the right to edit them in the interest of brevity. However, the full texts of all letters that we receive will be made available in the Tax Notes Microfiche Edition.

Senator **Chafee**. Now we are going to have a panel consisting of Mr. Mark Cohen from American Express, Alexander Perry from the Association of American Chambers of Commerce in Latin America, Mr. Liesenberg from the Asia-Pacific Council, Milan Ondrus, from the Council of Chambers in Europe and the Mediterranean, and Mr. Tom Hughes, American Chamber in Venezuela.

Well we are delighted you are here, gentlemen. Who is going to be first?

STATEMENT OF MARK COHEN, VICE PRESIDENT AND GENERAL TAX COUNSEL, AMERICAN EXPRESS CO.

Mr. **Cohen**. Thank you. My name is Mark Cohen. I am a vice president and general tax counsel for the American Express Co.

Senator **Chafee**. Now, you have the time divided up.

Mr. **Cohen**. Yes, sir.

Senator **Chafee**. You have. This is going to be 20 minutes. It is not much time, but go to it. [Laughter.]

Mr. **Cohen**. Right. I am a member of the U.S. Chamber's Task Force on International Tax Policy, on whose behalf I appear today. Many of the chamber's more than 98,600 members are vitally concerned about the tax treatment of Americans employed abroad. We welcome this opportunity to urge congressional consideration of the need for more favorable tax treatment in this area.

Our basic position is that because U.S. citizens and firms abroad are essential agents in promoting U.S. exports of goods and services, the tax law should not impair their ability to become more competitive with their foreign counterparts.

While the chamber has not yet taken a position with respect to the specific proposals which are the subject of this hearing, we look forward to working closely with you in fashioning a legislative solution that would promote rather than discourage the employment of U.S. citizens abroad.

Evidence exists that the competitive position of U.S. industry and international trade has been declining. Contributing to this unfortunate trend has been the absence of a clearly enunciated national emphasis on expansion of exports, lack of a carefully designed and consistent set of Government policies and programs to encourage exports, and insufficient public awareness as to the economic benefits to be derived therefrom.

One impediment which has been the subject of much criticism is the taxation of Americans employed abroad. The cost to U.S. firms of employing American workers overseas has risen dramatically in recent years, in large part because companies often provide tax equalization programs for these employees. However, many companies provide only partial equalization, which is why there is often an impact on employees as well as on the employers.

In some instances, rising tax costs have forced U.S. employees to reduce the number of their American workers or to replace them with foreign nationals. Increased tax costs hit particularly hard at the service industries, our most rapidly growing area of export, since the product sold by these industries is the technical know-how and managerial expertise of the American worker.

In the case of American Express, approximately half of what we call our assigned staff or our expatriate group today are third country nationals, which is, I believe, about double the case 5 years ago.

It was generally hoped that the Foreign Earned Income Act of 1978 would give some relief to what had become the excessive burden of U.S. taxes on U.S. workers abroad. However, significant problems regarding the taxation of foreign earned income remain.

As the recent report of the task force on the tax treatment of Americans Working Overseas of the President's Export Council found, Americans are still being taxed out of competition in overseas markets. The result is a sharp loss in the U.S. share of overseas business volume in vital economic sectors.

The current situation contributes to our negative balance of payments, loss of U.S. jobs to our competitors, and the decline in U.S. presence and prestige abroad. For some companies, the 1978 U.S. tax paid for their employees under their tax equalization programs was over 300 percent greater than it was in 1977 under pre-1976 U.S. tax law.

Since many U.S. businesses have hundreds and even thousands of Americans working overseas, the total cost to U.S. corporations has been substantial. These increased costs have forced some U.S. companies to cut back on or eliminate sending U.S. nationals overseas, and in many cases to replace their American workers with foreign nationals. The resulting loss of U.S. exports and employment costs the Treasury far more than revenue gained under sections 911 and 913.

At this point, I would like to defer to the chamber's four visitors from overseas, who will point out the impact of this issue in their areas of the world.

Senator CHAFEE. All right, fine. Thank you.

STATEMENT OF MILAN F. ONDRUS, CHAIRMAN, COUNCIL OF AMERICAN CHAMBERS OF COMMERCE, EUROPE AND THE MEDITERRANEAN

Mr. ONDRUS. My name is Milan Ondrus. I am vice president of the Europe, Middle East, and Africa for the Brunswick Corp., based in Brussels, Belgium. I am also chairman of the Council of American Chambers of Commerce in Europe and the Mediterranean on whose behalf I appear today.

In this short oral testimony, I would like to emphasize three points: the inequity of existing legislation, the increased repatriation of American businessmen from overseas locations home to the United States as a consequence of the law and the negative effects which the replacement of Americans with nationals or third country nationals has on American exports.

Incidentally, Mr. Chairman, if my accent throws you off, I am a U.S. citizen. I came to America in 1949 as an exile from Czechoslovakia, and an exile, as you may know, is a person who lost everything but his accent. [Laughter.]

The first point, on the inequity of existing legislation. Taxpayers are treated inequitably because taxation systems vary from country to country, and in most cases are different from that in the United States. Indirect taxes such as value added taxes in many foreign countries make up a large portion of the total tax burden and are substitutes to a large extent for direct income taxes.

For example, France derives almost 60 percent of its national revenue from indirect taxes. A similar situation exists in Belgium.

While an individual receives a credit against his U.S. tax for the foreign income taxes he pays, he receives no tax relief, credit, or deduction for indirect taxes paid. Therefore, even though the total amount expanded for taxation by similarly compensated individuals in two different countries may be the same, their net U.S. tax after credits can vary significantly.

My second point, on repatriation of American businessmen. You have heard from the Chase Econometric study that the number of Americans employed overseas has dropped by about 10 percent in recent years. I can only reinforce these findings. From a preliminary review of a survey which the American Chamber of Commerce in Belgium conducted recently, it appears that one-third of the American companies in Belgium have decreased their American staffs since 1976.

Of the companies represented in this one-third, 43 percent specifically cited the continued taxation of U.S. citizens as the sole or major reason for the withdrawal of American personnel. Sixty-one percent cited the combined effects of taxation and compensation costs.

These survey results are based on a 38 percent response to 1,160 questionnaires mailed to U.S. companies in Belgium. We have received 447 responses.

As to the third point, companies have been replacing their American employees overseas with foreign nationals who are understandably not thinking in terms of U.S. standards and specifications, but rather in their national product norm and past experience.

For example, if a company such as Fluor replaces an American procurement manager in a petrochemical project by a German, he will naturally tend to specify and look for VIN or electrical components and equipment with which he is familiar. He will order Siemens rather than General Electric product or Barmar product rather than paper corporation products from Chicago.

This has been confirmed in a recent study prepared by Prof. Andre Lorans at Insted in France, as reported in the June issue of International Management magazine, a McGraw Hill publication.

I am grateful for the opportunity to present our views. The ideal situation is one which would be fair to the United States, to its citizens residing abroad, and which would make American business abroad competitive with our Japanese, German, and other competitors. I urge you to put us on equal footing with them in the international marketplace.

Thank you, Mr. Chairman.

Senator CHAFEE. Fine. Thank you. I have some questions I will ask the panel, but who is next, Mr. Cohen?

STATEMENT OF GEORGE H. LIESENBERG, CHAIRMAN, TAX COMMITTEE, ASIA-PACIFIC COUNCIL OF AMERICAN CHAMBERS OF COMMERCE

Mr. LIESENBERG. I am a partner with the accounting firm of Arthur Young & Co. I live and work in Singapore. I have traveled

12,000 miles, and appreciate the opportunity to speak this afternoon on behalf of the——

Senator **Chafee**. I think we ought to welcome you. You must be a long distance traveler. I think we ought to give you more than 3 minutes. [General laughter.]

Mr. **Lifsenberg**. Actually, when we met last night, I attempted to have the group split the time based on miles traveled.

Senator **Chafee**. I see. [General laughter.]

Mr. **Liesenberg**. However, I was outvoted.

Senator **Chafee**. Mr. Cohen outvoted you on that one.

Mr. **Liesenberg**. I am speaking this afternoon on behalf of the Asian Pacific Council of American Chambers of Commerce, commonly called APCAC. APCAC represents the U.S. business community in 12 countries in the Asian Pacific region. In the short time alloted to me, I would like to make the following points with regard to the section 911-913 question.

First, the Foreign Earned Income Act of 1978 has done nothing but substantially increase the U.S. tax cost of Americans working in Asia. This is documented by a study prepared by APCAC comparing the tax cost—net of the foreign tax credit—based on 1978 income, under the pre-1976 rules with the cost under the rules under the Foreign Earned Income Act of 1978.

The following percentage increases in U.S. taxes were incurred by Americans working in Taiwan, 77 percent; Singapore, 42 percent; Malaysia, 39 percent; Hong Kong, 24 percent. The only country in our region which showed a decrease in tax under the Foreign Earned Income Act was Japan.

A copy of the complete study will be included in my written comments. Another major problem to the Americans overseas is the complexity of the law itself. Evidence of this is the size of the tax return of a bank executive, a close friend of mine working in Hong Kong. His tax return is 24 pages. Had he been working in the United States, the completed return would have been seven pages. One of the reasons for this problem is not only the law itself, but it is the restricted regulations issued by the IRS.

Examples of one of these restrictive regulations that will affect us in Asia require that we allocate our 913 deductions to foreign source income only. Now, the income that we earn is allocated between the United States and overseas, depending on where we work.

If we work 5 percent in the United States, 5 percent of our income is U.S. source, but yet Treasury has told us, or the IRS has told us that the deductions are all foreign source. Now, this has the effect of reducing the value of the foreign tax credit, and that is a case where we end up paying double tax.

The cost-of-living allowances under the IRS tables do not adequately reflect the differences. Just to give you one example, and I am comparing to the Organization Resource Counselors, Inc., a private firm that commercially prepares the cost of living tables. In the case of Hong Kong, the differential by ORC is $5,900. The IRS tables provide for no deduction at all. That is just an example.

The regulations prevent me from taking a deduction for leasing furniture as a housing expense. Economically, it doesn't pay to move furniture to Singapore, because the cost of moving it is more than the cost of having new furniture or leasing furniture, and yet the IRS says I cannot deduct as housing costs my cost of leasing my furniture.

These are just a couple of examples.

This ever-increasing U.S. tax is forcing many companies to employ third company nationals overseas, and is forcing many of the U.S. entrepreneurs and the U.S. businessmen to repatriate. I have got some examples of that which will be in my written comments.

In summary, with the current trade imbalance of the United States, APCAC feels that it is imperative that the U.S. tax laws be restructured to place the American working overseas in an equal position with his competitors, and to encourage U.S. citizens to live and work overseas to promote the sale of U.S. goods and services.

I encourage members of the committee to review the joint economic report issued recently on this question. I would like to go on record as showing the appreciation of APCAC to Senator Bentsen and his committee for the time, the effort, and the interest they showed in our problems in Asia.

Thank you.

Senator **Chafee**. On that trip they took.

Mr. **Liesenberg**. Yes. Thank you.

Senator **Chafee**. Fine. Thank you very much. We appreciate your coming such a long distance.

Next, Mr. Perry.

STATEMENT OF ALEXANDER PERRY, JR., PRESIDENT, ASSOCIATION OF AMERICAN CHAMBERS OF COMMERCE IN LATIN AMERICA

Mr. **Perry**. Mr. Chairman, I am Alexander Perry, Jr., from Argentina, a businessman with over 36 years' experience in Latin America. I am president of Patona Siarminera, a $1.3 billion new investment in mining going into Argentina at this time, as well as connected with other business.

I come before you today as president of the Association of American Chambers of Commerce in Latin America, a business organization with 17,000 members, corporate, as well as individual, in 18 countries of Latin America. A few words about Latin America.

As you know today, the area represents the only part of the world area where the United States has a favorable balance of trade. It is significant to note that exports to Latin America in 1979 represented 15 percent of total U.S. exports worldwide, and over 40 percent of U.S. exports to all developing countries, yet our exports to the region have grown less rapid than to the world as a whole, and over the past 5 years our market share has been falling.

In part, this reflects the increased share of oil imports from the Middle East, in part the increasingly aggressive efforts of our major European and Japanese competitors, efforts which are strongly supported by their government, but a significant factor is that our own Government does not provide the same kind of support.

Indeed, our exports suffer significantly from the restrictive effects of U.S. laws and regulations and policies. On a wider basis, I would like to review our worldwide commitments and problems. In the past decade, the United States imported approximately $108 billion more in merchandise than it exported. This unprecedented trade deficit, most of which occurred in the past 3 years, $86 billion, to be exact, contributed to the accumulation of surplus dollars abroad, dollars that have depreciated in value against most other major currency.

This declining value of the dollar has added to U.S. inflation and to uncertainty about the future of the international financial system. Besides the American economy and the unique international role of the dollar as the world's primary reserve currency and medium of exchange impose special responsibilities upon the United States.

It must correct the major imbalance between its imports and exports. This is a key to the future health of the economy of both the United States and the rest of the world. In 1971, the United States recorded its first trade deficit in this century, and went on to register a trade deficit in every year since then except 1973 and 1975.

Trade deficits are but one measure of a long-term decline in U.S. export performance. Some of the measures, the U.S. share of world exports shrank steadily from 21 percent in 1957 to 11.6 percent in 1979. The U.S. share of total exports by the 24 member countries of the Organization for Economic Cooperation and Development dropped from 22 percent in 1967 to 16 percent in 1978.

West Germany, with a population less than one-third that of the United States, became the world's leading exporter of manufactured goods in 1970. In 1978, it moved into first place in total exports, with 141.9 billion versus 141.2 billion for the United States. Even in the field of machinery and transportation equipment, an area of traditional American strength, West Germany has surpassed the United States as the leading exporter, and statistics may show that Japan will far surpass us.

Why this comparative decline in exports? Because countries such as West Germany and Japan are committed to the necessity of exporting, and their governmental leaders have given them the support needed to compete in this frenetic marketplace.

They are not the only countries that back their overseas people fully. I might also mention Great Britain, France, Italy, South Korea, and others.

We, the American businessmen abroad, must have the same support from our legislators as well as the administration if we are to meet the challenges of the coming decade. Instead of competing on a fully competitive basis. the American businessman abroad is going home, one of the principal reasons being the taxation questions of Americans abroad.

Let's remember in addition that lost business abroad, very often the American industrialist is not the prime loser, as many do have licensing arrangements and can manufacture abroad, in Japan or Germany, Great Britain, against a contract in Argentina or somewhere else. Who really loses? American labor.

The issue involved, then, is whether we stop the return of Americans abroad, reverse our trade patterns, and stop the fall of the dollar in world trade markets. Up to now, we have had much rhetoric on this vital issue by the administration, but no real concrete action. The issue of taxation of Americans abroad is a ridiculous one, when the other more important issues are considered in their proper perspective.

We are talking of approximately 150,000 to 170,000 U.S. citizens abroad, and perhaps tax revenues of $400 million to the Tax Bureau, as against jobs for American labor in the United States, stopping the devaluation of the dollar worldwide, and finding the much greater tax revenues that will be generated by increased export trade.

Thank you.

Senator **Chafee**. Thank you, Mr. Perry, and I appreciate the article that you wrote in the Times, which I put into the Congressional Record.

Mr. **Perry**. Thank you very much, Mr. Chairman.

Senator **Chafee**. Mr. Hughes?

STATEMENT OF THOMAS L. HUGHES, DIRECTOR AND PAST PRESIDENT, AMERICAN CHAMBER OF COMMERCE IN VENEZUELA

Mr. **Hughes**. Senator, my name is Tom Hughes. I am a past president of the Venezuelan-American Chamber of Commerce in Caracas, also a vice president of ACLA. I have lived in Venezuela for 22 years. I am a lawyer, and many of our clients, probably 90 percent of our clientele are American companies doing business in Venezuela. We will be filing a statement with your permission that will go into more detail as to what we would like to say.

I will be very brief. We are firmly convinced that the existence of Americans working overseas is vital to the sale of U.S. products abroad and the continued remittance back to the United States of dividends from investments already abroad and royalties from technical assistance rendered in foreign countries.

Particularly hard hit under the new tax law are the large overseas design, engineering, procurement, and construction projects. To give you an example of Venezuela, at the present time, Venezuela is trying to develop its tar belt or heavy oil belt, which has 700 billion barrels of reserves. The current cost of that project if it were to be completed today, at today's costs, without any inflation, for the development of some production and a 125,000 barrel refinery, which is a relatively small facility, is estimated at $8 billion.

Now, if an American company or group of American companies gets that project, we estimate there will be millions of dollars remitted back to the United States in engineering fees, technical assistance fees, and 50 percent of that, $4 billion worth of equipment will be ordered from the country presumably where those engineers come from.

This is just the beginning, the tip of the iceberg in the development of that particular tar belt.

I might also comment very briefly on the incredibly complicated forms that a U.S. citizen residing abroad must fill out in order to obtain the limited benefits, if any, available under section 913. I am convinced that only the employee of a multinational corporation, which incidentally I am not, with the combined genius of their tax department and that of outside accountants, can help him fill them out correctly and in less than a week's time.

Surely there must be a simpler method of calculating tax liability, and an off the top exclusion or complete exclusion would eliminate, obviously, much of this problem.

To make my point, IRS publication No. 54, revised in November of 1979, entitled "Tax Guide for U.S. Citizens Abroad," is 45 pages long of small print. This is an increase of one-third in size over the same publication for the previous year, which was only 34 pages long. This does not, of course, include the instructions on how to calculate the foreign tax credit for U.S. citizens which is contained in another 1979 publication of a mere 24 pages.

Then we get down to the instruction on how to fill out form 2555, which permits you to calculate your deductions, if any, under section 913. This is eight pages long. The U.S. Court of Claims recently, in referring to the foreign tax credit, referred to it as "the unknotted short pieces which we have patiently picked out one by one from this tangled mass."

Now, that is a very sophisticated court that has made that statement.

We firmly believe that an American presence abroad is desirable and necessary to maintain and stimulate exports. We feel that the tax equality provisions of 913 are utterly inadequate in that they fail to take into account VAT and similar indirect taxes which exist abroad.

We feel furthermore, and this is very important, that there must be a positive tax incentive for an American to go abroad. There are all sorts of things in the third world particularly which are not equivalent to the United States. Two friends of mine have been kidnapped in Venezuela, and one in Colombia, and I wish that Mr. Lubick would hear that type of anecdotal evidence.

Without some tax incentive to go abroad, very frankly an American citizen is a fool to live in some of the Third World countries. Therefore, we advocate the restoration of U.S. competitive equality and construction contracts and exports by excluding all foreign earned income of bona fide—I underline bona fide—overseas residents. That should take care of the person sojourning on the Riviera. This would also eliminate, incidentally, constant indexing for increased cost of living abroad and the housing allowance complications.

Thank you very much.

Senator CHAFEE. Thank you, gentlemen. I want to ask you a question, and you can just raise your hands yes or no.

Mr. Hughes has said he favors the complete exclusion of earned income. My bill, as you know, does not do that. Senator Bentsen's and Senator Jepsen's, on the other hand, does. My bill exempts the first $50,000 for your first 2 years abroad. Then as you go into your third year, you would be up to $65,000.

How many opt for the total exclusion? Raise your hands.

[A show of hands.]

[General laughter.]

Senator CHAFEE. Amazing result.

Well, let me say, I see problems with that. I know the point Mr. Hughes made about the constant indexing as inflation boosts the requirements. I think politically we would have some trouble with that.

How about the number of months abroad? The present is 17 out of 18 months. Senator Bentsen would say you would have to be there 11 out of 12. What do you say about that? Who say 17 out of 18?

[No response.]

Senator CHAFEE. Who say 11 out of 12?

[A show of hands.]

Senator CHAFEE. Why, Mr. Hughes? You have been down there 22 years.

Mr. HUGHES. Well, I have been there 22 years, so 17 out of 18 would cover me very nicely, but you do have some people that come out on some of these engineering projects, and Senator, they come sort of on a rotation basis. Maybe certain engineers would be there for a certain phase of the project. Then they go back home. Then you have another group that comes out for let's say the construction supervision, and finally a third group perhaps for the startup of the plant.

I think probably most people would be covered by 17 out of 18, but I think it would be fair maybe to have a 1-year minimum.

Senator CHAFEE. I tilt towards the 11 out of 12. It seems to me that is a standard setup. You get one month home a year, sort of home leave. What about targeting, as Mr. Lubick was discussing, in that it would only apply to certain hardship posts? It wouldn't cover you, Mr. Perry. You are not in the Middle East.

Mr. PERRY. No, I am not in the Middle East, but we are going into this big project of ours, spending $1.3 billion. We are going to be looking at some American companies up here to be the main contractor, but I don't feel at this point that there is going to be too much chance of their getting our business.

Senator CHAFEE. Because of the extra cost.

Mr. PERRY. We have just seen Morris and Knudson, lose a big job down in Buenos Aires on the——

Senator CHAFEE. Who got the job?

Mr. PERRY. They bid $2.2 billion, and the French bid $1.4 billion. Now, all of that difference was not due to taxation, but a lot of it was.

Senator CHAFEE. How significant do you think this taxation issue is? I know there is a series of problems. There is the whole human rights thing, particularly those of you from South America see that. You see the Foreign Corrupt Practices Act. How significant? Do you rate this as pretty significant, as you see it?

Mr. PERRY. Yes, because this will keep the Americans on the job down there. And we are faced with Americans going back home. We have a lot of problems keeping the American schools going, and many things, because our membership is going down.

Senator CHAFEE. Can you give me any specifics? I mean, it seems to me that when I saw you last, when we had that meeting, it was pointed out that the membership in the American Chamber in Buenos Aires or wherever was 400. Now it is 100. Do you have any specifics?

Mr. PERRY. No. As far as membership in the chamber goes——

Senator CHAFEE. Well, I don't want to use that as the end-all, but I would like data that can show an actual decline. Mr. Lubick will come forward with statistics that show that there are more Americans abroad than ever.

Mr. **Perry**. There certainly are, and we can develop those figures.

Senator **Chafee**. What I am really interested in, anecdotal though it might be, is what do you see? Do you see them going home? Mr. Hughes?

Mr. **Perry**. They are being replaced by Europeans.

Mr. **Hughes**. Senator, I would like to make one comment on the statistics. The State Department has put out some figures which would indicate that a very high percentage of our total population was living abroad. I took a look at the figure for Caracas, and it was 23,000. That is simply not so. I found out what the State Department does or the embassy does. Everyone that has been into the consulate in the last 10 years to register or to get a passport renewed is listed.

Now, most of those people have gone home. Some have died. But they are kept on the records for 10 years.

[General laughter.]

Mr. **Hughes**. There is no way there are 23,000 people there.

Senator **Chafee**. Like the Cook County voting list.

[General laughter.]

Mr. **Hughes**. I did not wish to make a political reference, but it is comparable. Also, we took a look at our chamber very hastily, and I am not sure this is the complete data, as to the top executives that had gone home in the last year or been replaced by a third party national.

Now, we are a fairly small chamber compared with some of the other countries. We have 500 corporate members, and probably 40 percent of those are Venezuelan companies. There were 20 people that were replaced during the past year. During the previous 12 months, no one was replaced by a third country national. We are trying to develop some of those statistics. We don't have them yet.

Senator **Chafee**. Did you have anything? I feel you are entitled to a few extra seconds.

Mr. **Liesenberg**. Thank you, Senator.

I would like to make a comment on this question of the returning Americans. Singapore happens to be one of the places where the total work permits for Americans have increased in the last 2 years by 20 percent. At the same time, though, the work permits for Japanese competitors has increased like 40 percent.

So, although I am in a situation in Singapore where there has been no net decrease of Americans, I can cite examples of where in construction and in the tooling industry some very key Americans have left, but even though we don't have a net decrease in Americans, our competitors or the presence of our competitors is increasing substantially faster than we are. Again, I think it is similar to the question of exports. I think our exports have not decreased. I think they have increased, yet our percentage of the market is going down.

Senator **Chafee**. Yes. I think that is a very valuable point. Thank you very much, gentlemen. We appreciate your coming. You have all come a long distance.

[The prepared statement of the preceding panel follows:]

STATEMENT OF

ASSOCIATION OF AMERICAN CHAMBERS OF COMMERCE IN LATIN AMERICA (AACCLA)

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

COMMITTEE ON FINANCE

UNITED STATES SENATE

June 26, 1980

The Honorable Harry F. Byrd, Jr.
Chairman
Subcommittee on Taxation and
Debt Management Generally
Committee on Finance
United States Senate
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Byrd:

On behalf of The Association of American Chambers of Commerce in Latin America (AACCLA), we submit the following statement for inclusion in the record of your subcommittee hearings on the taxation of foreign earned income.

We thank you for this opportunity to express our views to you and your subcommittee.

Very truly yours,

Alexander Perry, Jr.
President, Association
of American Chambers
of Commerce in Latin
America

WRITTEN STATEMENT OF THE
ASSOCIATION OF AMERICAN CHAMBERS OF COMMERCE IN LATIN AMERICA (AACCLA)

SUBMITTED TO

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

COMMITTEE ON FINANCE

UNITED STATES SENATE

June 28, 1980

The following is submitted as a statement of the views of the Association of American Chambers of Commerce in Latin America (AACCLA) with respect to the taxation of foreign earned income, presently under consideration by the United States Senate.

STATEMENT OF

ASSOCIATION OF AMERICAN CHAMBERS OF COMMERCE IN LATIN AMERICA (AACCLA)

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

COMMITTEE ON FINANCE

UNITED STATES SENATE

Introduction

I am Alexander Perry, Jr. from Argentina, a businessman with over 36 years experience in Latin America. I am President of Pachon S.A. Minera, a $1,000,000.00 U.S. investment in mining in Argentina, as well as other businesses.

I come before you today as President of the Association of American Chambers of Commerce in Latin America (AACCLA), a business organization representing over 17,000 companies and businessmen involved in over $28 billion worth of U.S. investment in the region and over $40 billion in total U.S.-Latin American trade.

We appreciate very much this opportunity to submit this written testimony with respect to proposals relating to taxation of Americans abroad. We wish to express our support for S.2283 introduced by Senator John H. Chafee (R-RI), for S.2321 introduced by Senator Roger Jepsen (R-IA) and for S.2418 introduced by Senator Lloyd Bentsen (D-TX). We find these legislative proposals responsive to the needs to place U.S. taxpayers abroad on a competitive basis with citizens of other industrial nations.

Issues

The major issue is whether the provisions for the taxation of Americans working abroad should be modified to afford more generous relief.

The two related issues are:

a. Total Exemption:

> Whether a system of total exemption from U.S. taxes for all foreign income earned abroad by U.S. citizens should be adopted. This system should be consistent with a concept of taxing U.S. residents abroad on the basis of residency, a method followed by most industrialized countries.

b. Exclusions:

> If only part of the individual's foreign earned income is to be excluded, should the relief be tailored to the specific circumstances of the taxpayer, or should it be in the form of a flat dollar or formula amount.

Present Law

a. Law Prior to the Foreign Earned Income Act of 1978:

United States citizens and residents are generally taxed by the United States on their worldwide income with the allowance of a foreign tax credit for foreign taxes paid. However, for years prior to 1978, U.S. citizens working abroad could exclude up to $20,000 of earned income a year, if they were present in a foreign country for 17 out of 18 months or they were bona fide residents of a foreign country for a period which included an entire taxable year (Code sec. 911). In the case of individuals who had been bona fide residents of foreign countries for three years or more, the exclusion was increased to $25,000 of earned income. In addition, under the law prior to 1978, foreign taxes paid on the excluded income were creditable against the U.S. tax on any foreign income above the $20,000 (or $25,000) limit.

The Tax Reform Act of 1976 would generally have reduced the earned income exclusion for individuals working abroad to $15,000 per year. However, the Act would have retained a $20,000 exclusion for employees of domestic charitable organizations. In addition, the Act would have made certain modifications in the computation of the exclusion.

These amendments made by the 1976 Act never went into general effect because the Foreign Earned Income Act of 1978 generally replaced the section 911 earned income exclusion for years beginning after December 31, 1977, with a new system of itemized deductions for the excess costs of working overseas. However, taxpayers were permitted for 1978 to elect to be taxed under the new provisions, or under the Tax Reform Act of 1976.

b. Foreign Earned Income Act of 1978:

The Foreign Earned Income Act of 1978 generally replaces the section 911 earned income exclusion for years beginning after December 31, 1977, with a new system of itemized deductions for the excess costs of working overseas. The basic eligibility requirements for the deduction are generally the same as for the prior earned-income exclusion.

The new excess living cost deduction (new Code sec. 913) consists of separate elements for the general cost of living, housing, education, and home leave costs.

The cost-of-living element of the deduction is generally the amount by which the cost of living in the taxpayer's foreign tax home exceeds the cost of living in the highest cost metropolitan area in the continental United States (other than Alaska). The deduction is based on the spendable income of a person paid the salary of a Federal employee at a grade level GS-14, step 1, regardless of the taxpayer's actual income. The housing element is the excess of the taxpayer's reasonable housing expenses over his base housing amount (generally one-sixth of his net earned income). The education deduction is generally the reasonable schooling expenses for the education of the taxpayer's dependents at the elementary and secondary levels. The deduction for annual home leave consists of the reasonable cost of coach airfare transportation for the taxpayer, his spouse, and his dependents from his tax home outside the United States to his most recent place of residence within the United States.

In addition, taxpayers living and working in certain hardship areas are allowed a special $5,000 deduction in order to compensate them for the hardships involved and to encourage U.S. citizens to accept employment in these areas. For this purpose, hardship areas are generally those designated by the State Department as hardship posts where the hardship post allowance paid government employees is 15 percent or more of their base pay.

As an exception to these new rules, the Act permits employees who reside in camps in hardship areas to elect to claim a $20,000 earned income exclusion (under Code sec. 911) in lieu of the new excess living cost and hardship area deductions. No foreign tax credit would be allowed for foreign taxes attributable to the excluded amount. For taxpayers electing the exclusion, the camp would be treated as the employer's business premises so that the exclusion for employer-provided meals and lodging can also be claimed (provided the other requirements of Code sec 119 are satisfied).

The 1978 Act liberalizes the deduction for moving expenses for foreign job-related moves, increasing the dollar limitations applicable to temporary living expenses. The Act also extends up to four years while the taxpayer is working abroad the 18- or 24-month period for reinvestment of proceeds realized on the sale of a principal residence.

Legislative History of Taxation of U.S. Citizens Abroad

Originally enacted in 1926, the exclusion under Section 911 was an unlimited exemption of foreign earned income for citizens spending six months a year outside the United States. It was intended as an incentive to encourage Americans to live overseas and sell U.S. products abroad. The House Committee Report of the time clearly indicated that the language first proposed was meant to benefit export salesmen and thereby increase U.S. foreign trade.

The provision as enacted was not limited to export salesmen, being broader in scope. Over the years section 911 has undergone a series of modifications, introducing concepts of bona fide foreign residence, physical presence abroad, and limitation on dollar amounts excludable, all designed primarily to curb abuses by those who could arrange their employment abroad so as to take advantage of an opportunity to avoid U.S. taxes.

The Case for Improving U.S. Exports

Latin America today represents the only area of the world where the U.S. still has a favorable balance of trade. It is significant to note that exports to Latin America in 1979 represented 15 percent of total

U.S. exports worldwide and over 40 percent of U.S. exports to all developing countries.

Yet our exports to the region have grown less rapidly than to the world as a whole, and over the past five years our market share has been falling. In part this reflects the increased share of oil imports from the Middle East; in part, the increasingly aggressive effotts of our major European and Japanese competitors -- effots which are strongly supported by their governments. But a significant fact is that our own government does not provide the same kind of support -- indeed, our exports suffer significantly from the restrictive effects of U.S. laws, regulations and policies, and in particular, from our system of taxing U.S. citizens abroad.

On a wider basis, I would like to review our worldwide commitments and problems.

In the past decade, the United States imported approximately $108 billion more in merchandise than it exported. This unprecedented trade deficit, most of which occurred in the past three years, $186 billion to be exact, contributed to the accumulation of surplus dollars abroad -- dollars that have depreciated in value against most other major currencies. This declining value of the dollar has added to U.S. inflation and to uncertainty about the future of the international financial system.

The size of the American economy, and the unique international role of the dollar as the world's primary reserve currency and medium of exchange, impose special responsibilities upon the United States. It must correct the major imbalance between its imports and exports. This is a key to the future health of both the U.S. and world economies.

In 1971, the United States recorded its first trade deficit in this century -- and went on to register a trade deficit in every year since then except 1973 and 1975.

Trade deficits are but one measure of a long-term decline in U.S. export performance. Some other measures:

-- the U.S. share of world exports shrank steadily from 21% in 1957 to 11% in 1978.

-- the U.S. share of total exports by the 24 member countries of the Organization for Economic Cooperation and Development (OECD) dropped from 22% in 1967 to 16% in 1978.

-- West Germany -- with a population less than one-third that of the United States --

became the world's leading exporter of manufactured goods in 1970. In 1973 it moved into first place in total exports, with $141.9 billion versus $141.2 billion for the United States.

-- even in the firld of machinery and transportation equipment, an area of traditional American strength, West Germany has surpassed the United States as the leading exporter. And final 1979 statistics may show that Japan has taken over the number two position.

Data from other sectors -- with the notable exception of agriculture -- tell much the same story: the United States is not holding its own in international competition for exports, even though U.S. exports are growing faster than its sluggish economy.

Why this comparative decline in exports? Because countries such as West Germany and Japan are committed to the necessity of exporting and their national leaders have given them the support needed to compete in this frenetic marketplace. They are not the only countries that back their overseas people fully -- I might also mention Great Britain, France, Italy, South Korea and others. We -- the American businessmen abroad -- must have this same support from our legislature as well as the Administration if we are to meet the challenges of the coming decade.

The Importance of Tax Benefits for Americans Living and Working Abroad

It is a fact of business life today that getting competent and reliable U.S. technicians, professionals, and managers to take protracted overseas assignments is difficult. Private studies indicate that after-tax income, along with promotions, are the two most important factors for Americans in deciding whether to accept an assignment overseas. Accordingly, many U.S. multinationals historically have depended on overseas earned income tax incentives as part of the favorable consideration given by Americans who accept such assignments.

The added expense of living and working abroad is an onerous burden on U.S. employers and their U.S. employees. Not only is the initial transportation expense considerably greater than in the case of a domestic transfer, but there are typically more start-up costs to both employer and employee involved in setting up a new household (such as new furniture, new automobiles, etc.) and a new place of employment. Add to this, the expense of educating children in American schools overseas, together with the expenses involved in maintaining their family, investment, and other business and personal ties with the United States (such as telephone and transportation expenses): As a result of this frequently one finds today a precarious financial situation for many American families. At the same time, those U.S. families must make their purchases on the local economy of the host country at prices inflated by both U.S. dollar devaluation and the host country's own inflation. Accordingly, a U.S. expatriate taxpayer should also be allowed a substantial measure of relief from these added expenses.

During the 1978 hearings of the Senate Finance Committee on "Taxation of Americans Working Abroad", Senator Bentsen illustrated the disincentives hindering Americans from accepting positions overseas, and the resulting damage to U.S. export opportunities, with the following example:

> A Venezuelan businessman who spoke to the Senator complained that he had a hard time hiring Americans to operate the American-made equipment. Frequently the prospective employee would agree to a salary figure, but upon making a

visit to Venezuela to investigate availability of housing, education, and other necessities, would turn the job down. The reason repeatedly given for refusing the position was that the prospective American employee could not afford the added living expenses and taxes he would incur.

Our Position On Taxation of U.S. Citizens Abroad

The present section 913 deductions for persons living abroad, which were designed to deal with the higher cost of living outside the United States, have proven inadequate for that purpose. Not only are the 913 deductions unrealistically restrictive (for example the educational expense deduction covers only schooling through the 12th grade) but the limitations and the other rules are extraordinarily complex, requiring comprehension of hitherto unknown tax terms such as "less housing amount", "qualified cost of living differential", and "qualified hardship area deduction". As in the case of other complex "relief" provisions of the Internal Revenue Code, section 913 may frequently go unused to its fullest potential because of lack of information or comprehension--or for that matter, mere frustration at the compliance burden --on the part of the taxpayer. Furthermore, many Americans abroad have found the cost-of-living differential tables used to apply the present section 913 rules unrealistic.

An added benefit of the simplication which would follow reenactment of a pre-1976-type earned income exclusion or a new total exemption from U.S. taxation on foreign earned income, is likely to be increased compliance among U.S. citizens in foreign countries with U.S. tax laws, especially if such exclusion is coupled with some realistic deduction features. To begin with, the reduced tax burden--both in amount of tax and amount of effort to file proper returns--would go a long way toward encouraging taxpayers to voluntarily meet their U.S. tax obligations. Furthermore, audits of returns and taxpayerservice assistance to overseas taxpayers would become a considerably simpler matter than under the present version of section 913. This is no minor consideration in light of the small number of IRS Revenue Service Representatives stationed overseas and the added logistical burden incident to conducting audits of distant taxpayers.

Although some congressional and government officials may argue that income tax incentives to overseas employees are in the nature of export incentives, in theory and practice, both the earned income exclusion regardless of the nature of the employee's activity. They therefore do not represent violation of any international agreements against export subsidies such as GATT. It is accurate to say that while such tax relief measures impact favorably on the export sector, they are of sufficient benefit to international trade and investment generally and are not restricted to export promotion activities.

Instead of competing on a fully competitive basis, the American businessman abroad is going home, one the princplal reasons being the taxation question of Americans abroad.

Due to the position of the dollar in international trade and the world's financial structure, we can no longer permit our balance of trade to deteriorate further, as this will in turn have deeper effects on devaluation of the dollar abroad. Inflation at home, and ultimately the welfare of our people through lack of jobs.

Let's remember that in lost business abroad, very often the American industrialist is not the prime loser, as many do have licensing arrangements and can manufacture abroad in Japan, Germany and Great Britain against a contract in Argentina or somewhere else. Who really loses? American labor.

The issue involved then is whether we stop the return of Americans abroad, reverse our trade patterns and stop the fall of the dollar in world trade markets. Up to now we have had much thetoric on this vital issue by the Administration, but no real concrete action.

The issue of taxation of Americans abroad is a ridiculous one, when the other more important issues are considered in their proper perspective. We are talking of approximately 150,000 to 170,000 U.S. citizens abroad and perhaps tax revenues of 400,000,000 to the Treasury as against jobs for American labor in the U.S., stopping the devaluation of the dollar worldwide and, finally, the much greater tax revenues generated by increased export trade.

Conclusions and Recommendations

It seems ironic that while the communists paint on the walls of many foreign countries "Yankee Go Home", there are many who by a short-sighted tax policy are perhaps unwittingly saying, "Yankee Come Home."

We all firmly believe that it is to the benefit of the U.S. balance of payments and to the maintenance of employment in the U.S. export industries that U.S. citizens be encouraged to live abroad and certainly not be penalized for working abroad.

Although "The Foreign Earned Income Act of 1978" granted special deductions for certain foreign living expenses and generally reduced the tax liability which would have been due under the "Tax Reform Act of 1976", the tax payments of U.S. citizens resident abroad are greater than they would have been under the legislation in effect prior to 1976. In addition, the extensive reporting requirements under the 1978 legislation have created difficult compliance burdens, with resulting high administrative costs.

We believe that a legislative solution is due this year which would allow U.S. enterprises to compete on equal terms with foreign firms, in addition to reinstating tax incentives for U.S. citizens working abroad. Any further Congressional delay for the purpose of additional study or evaluation of this issue would be unnecessary and detrimental to the global interest of the United States.

We strongly urge the Subcommittee to consider the adoption of a system of total exemption from U.S. taxation for all income earned abroad by U.S. citizens. This system would be consistent with a concept of taxing U.S. residents abroad on the basis of residency, a method followed by most industrialized countries. Should Congress decide that this approach, at least theoretically, is subject to abuse, then this method could be limited to a strict residency test. If Congress instead decides to support the general exclusion approach, then we urge the Subcommittee to adopt a flat exclusion in the range of dollars 50,000 to 65,000 with a $5,000 yearly increase in addition to an appropriate housing deduction.

We feel that such a flat exclusion is equal to the amount granted in 1962 when the dollars 20,000 limit was enacted. This is so because since 1962 the Consumer Price Index has increased 162.7 percent and an equivalent amount in 1980 would be dollars 52,582. Accordingly, the dollars 25,000 exclusion granted in 1964 to U.S. citizens resident abroad for more than three years, would correspond to dollars 65,185 today.

We believe that the facts set forth in our statement firmly support our petition that tax relief and incentives be granted to U.S. citizens employed overseas in order to effectively maintain -- and further promote -- U.S. exports and commercial competitiveness abroad. We urge remedial action now!

Thank you very much.

AMERICAN CHAMBER OF COMMERCE
OF VENEZUELA
CAMARA DE COMERCIO AMERICANA DE VENEZUELA

Frank J. Amador, Executive Director
Apartado 5181/Caracas 101, Venezuela

Telephone 91.22.88
Cables "AMBERCO"

STATEMENT OF
THE AMERICAN CHAMBER OF COMMERCE OF VENEZUELA

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

COMMITTEE ON FINANCE

UNITED STATES SENATE

AMERICAN CHAMBER OF COMMERCE
OF VENEZUELA
CAMARA DE COMERCIO AMERICANA DE VENEZUELA

Frank J. Amador, Executive Director
Apartado 5101/Caracas 101, Venezuela

Telephone 91.23.00
Cables "AMBERCO"

June 26, 1980

The Honorable Harry F. Byrd, Jr.
Chairman
Subcommittee on Taxation and
Debt Management Generally
Committee on Finance
United States Senate
2227 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Byrd:

On behalf of the American Chamber of Commerce of Venezuela, we submit the following statement for inclusion in the record of your subcommittee hearings on the taxation of foreign earned income.

We thank you for this opportunity to express our views to you and your subcommittee.

Very truly yours,

Thomas L. Hughes
Director and Past President

WRITTEN STATEMENT OF THE
AMERICAN CHAMBER OF COMMERCE OF VENEZUELA

SUBMITTED TO

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

COMMITTEE ON FINANCE

UNITED STATES SENATE

June 26, 1980

The following is submitted as a statement of the views of the American Chamber of Commerce of Venezuela with respect to taxation of foreign earned income, presently under consideration by the United States Senate.

INTRODUCTION

Who We Are

I am Thomas L. Hughes, past president of the Venezuelan American Chamber of Commerce and Industry located in Caracas and I have lived in Venezuela for over 24 years. I am a senior partner of Travieso, Evans, Ponte & Hughes, an international law firm located in Caracas, Venezuela. Our Chamber is a binational organization with over 1,000 individuals and 500 corporate members. The majority are branches or affiliates of U.S. companies. In addition, many of the Venezuelan corporate members employ U.S. citizens in managerial or technical positions.

Our organization is associated with the Council of the Americas, the Chamber of Commerce of the United States, and the Association of American Chambers of Commerce in Latin America (AACCLA), the latter organization representing over 17,000 companies and businessmen involved in over $28 billion worth of U.S. investment in the region and over $40 billion in total U.S.-Latin American trade.

We appreciate very much this opportunity to submit this written testimony with respect to proposals relating to taxation of Americans abroad. We wish to express our support for S.2283 introduced by Senator John H. Chafee (R-RI), for S.2321 introduced by Senator Roger Jepson (R-IA) and for S.2418 introduced by Senator Lloyd Bentsen (D.-TX). We find these legislative proposals responsive to the needs to place U.S. taxpayers abroad on a competitive basis with citizens of other industrial nations.

Issues

The major issue is whether the provisions for the taxation of Americans working abroad should be modified to afford more generous relief.

The two related issues are:

a. Total Exemption:

> Whether a system of total exemption from U.S. taxes for all foreign income earned abroad by U.S. citizens should be adopted. This system should be consistent with a concept of taxing U.S. residents abroad on the basis of residency, a method followed by most industrialized countries.

b. Exclusions:

> If only part of the individual's foreign earned income is to be excluded, should the relief be tailored to the specific circumstances of the taxpayer, or should it be in the form of a flat dollar or formula amount.

Present Law

a. Law Prior to the Foreign Earned Income Act of 1978:

United States citizens and residents are generally taxed by the United States on their worldwide income with the allowance of a foreign tax credit for foreign taxes paid. However, for years prior to 1978, U.S. citizens working abroad could exclude up to $20,000 of earned income a year, if they were present in a foreign country for 17 out of 18 months or they were bona fide residents of a foreign country for a period which included an entire taxable year (Code sec. 911). In the case of individuals who had been bona fide residents of foreign countries for three years or more, the exclusion was increased to $25,000 of earned income. In addition, under the law prior to 1978, foreign taxes paid on the excluded income were creditable against the U.S. tax on any foreign income above the $20,000 (or $25,000) limit.

The Tax Reform Act of 1976 would generally have reduced the earned income exclusion for individuals working abroad to $15,000 per year. However, the Act would have retained a $20,000 exclusion for employees of domestic charitable organizations. In addition, the Act would have made certain modifications in the computation of the exclusion.

These amendments made by the 1976 Act never went into general effect because the Foreign Earned Income Act of 1978 generally replaced the section 911 earned income exclusion for years beginning after December 31, 1977, with a new system of itemized deductions for the excess costs of working overseas. However, taxpayers were permitted for 1978 to elect to be taxed under the new provisions, or under the Tax Reform Act of 1976.

b. Foreign Earned Income Act of 1978:

The Foreign Earned Income Act of 1978 generally replaces the section 911 earned income exclusion for years beginning after December 31, 1977, with a new system of itemized deductions for the excess costs of working overseas. The basic eligibility requirements for the deduction are generally the same as for the prior earned-income exclusion.

The new excess living cost deduction (new Code sec. 913) consists of separate elements for the general cost of living, housing, education, and home leave costs.

The cost-of-living element of the deduction is generally the amount by which the cost of living in the taxpayer's foreign tax home exceeds the cost of living in the highest cost metropolitan area in the continental United States (other than Alaska). The deduction is based on the spendable income of a person paid the salary of a Federal employee at a grade level GS-14, step 1, regardless of the taxpayer's actual income. The housing element is the excess of the taxpayer's reasonable housing expenses over his base housing amount (generally one-sixth of his net earned income). The education deduction is generally the reasonable schooling expenses for the education of the taxpayer's dependents at the elementary and secondary levels. The deduction for annual home leave consists of the reasonable cost of coach airfare transportation for the taxpayer, his spouse, and his dependents from his tax home outside the United States to his most recent place of residence within the United States.

In addition, taxpayers living and working in certain hardship areas are allowed a special $5,000 deduction in order to compensate them for the hardships involved and to encourage U.S. citizens to accept employment in these areas. For this purpose, hardship areas are generally those designated by the State Department as hardship posts where the hardship post allowance paid government employees is 15 percent or more of their base pay.

As an exception to these new rules, the Act permits employees who reside in camps in hardship areas to elect to claim a $20,000 earned income exclusion (under Code sec. 911) in lieu of the new excess living cost and hardship area deductions. No foreign tax credit would be allowed for foreign taxes attributable to the excluded amount. For taxpayers electing the exclusion, the camp would be treated as the employer's business premises so that the exclusion for employer-provided meals and lodging can also be claimed (provided the other requirements of Code sec 119 are satisfied).

The 1978 Act liberalizes the deduction for moving expenses for foreign job-related moves, increasing the dollar limitations applicable to temporary living expenses. The Act also extends up to four years while the taxpayer is working abroad the 18- or 24-month period for reinvestment of proceeds realized on the sale of a principal residence.

Legislative History of Taxation of U.S. Citizens Abroad

Originally enacted in 1926, the exclusion under Section 911 was an unlimited exemption of foreign earned income for citizens spending six months a year outside the United States. It was intended as an incentive to encourage Americans to live overseas and sell U.S. products abroad. The House Committee Report of the time clearly indicated that the language first proposed was meant to benefit export salesmen and thereby increase U.S. foreign trade.

The provision as enacted was not limited to export salesmen, being broader in scope. Over the years section 911 has undergone a series of modifications, introducing concepts of bona fide foreign residence, physical presence abroad, and limitation on dollar amounts excludable, all designed primarily to curb abuses by those who could arrange their employment abroad so as to take advantage of an opportunity to avoid U.S. taxes.

Our Position On Taxation of U.S. Citizens Abroad

We are firmly convinced that the existence of Americans working overseas is vital to the sale of U.S. products abroad and the continued remittance back to the United States of dividends from investments abroad and royalties from technical assistance rendered in foreign countries. Under the present system of taxation of Americans working overseas, it has simply become too expensive for even the largest of companies to maintain Americans abroad when nationals of other countries, who do not have to pay home-country taxes, can be hired at a salary cost of perhaps one-half to one-third of what it costs to hire an American.

Particularly hard hit are those companies engaged in large overseas engineering, design, procurement and construction projects. We calculate that under the existing tax system, coupled with the higher cost of living in Venezuela, an American in Venezuela must earn two and one-half times what he earns in the United States just to stay even, net after taxes, with no change in his life style. When the additional costs of U.S. personnel are passed along to the owner of a large constrution project, the American company is simply priced out of the market by firms from such countries as Germany, Italy and Japan. It has been argued that the American companies should simply switch to using third country nationals, but we are convinced that the foreigners who replace Americans will in the normal course prefer to use equipment and materials that they are most familiar with, which will be from their own countries of origin.

At present various companies from different nations are competing in Venezuela for contracts involving the development of Venezuela's huge heavy oil belt, estimated to contain more than 700 billion barrels of reserves. The proposed initial development of production and a refinery, designed for a mere 125,000 barrels a day of crude, is estimated to cost at today's prices about US$ 8 billion. It will involve thousands of foreign engineers and technical personnel. If the winner of these contracts are American firms, we will generate not only millions of dollars in engineering and technical assistance fees remitted back to the United States, but more important, billions of dollars of orders for equipment. It is estimated that 50% of the currently projected US$ 8 billion cost would go for equipment -- a US$ 4 billion dollar order. If the Japanese or Germans win these contracts, it is more than probable that the equipment orders will go to those countries instead of to the U.S. It is essential that we have an American presence in Caracas to get these orders.

Jobs and Unemployment

We are convinced that Americans abroad in less-developed countries, such as Venezuela and the other areas of Latin America, generate jobs in the United States rather than take away jobs. Most of the countries in the world today have closed the frontier on imports of many items; American companies must either get into the foreign market with a local organization or get completely out. In the last two decades, protective tariffs or prior licensing systems have virtually prohibited the importation into Venezuela and other Latin American countries of such finished products as textiles, automobiles, household appliances, television sets, and a host of other articles. As a general rule, we can no longer ship into Venezuela and similar countries finished consumer products. We must either import components or nothing in many areas. In Venezuela and many other developing countries, these products do not come back to the United States with local labor added; they are consumed by the ever increasing local population with its constantly rising purchasing capacity.

Intimately linked in many cases with the creation of markets abroad for U.S. products, it should be noted that in 1974 U.S. firms earned $3.6 billion from foreign-located companies and individuals in the form of royalty and fee payments for the use of U.S. technology. Approximately $2.8 billion of those came from investment-related technology transfer and $0.8 billion from non-investment related royalties and fees. Although in some cases such fees may be generated by the licensing of patents alone, in most cases they are coupled with or dependent upon U.S. management, know-how and technical experience rendered in the foreign country by U.S. citizens. These receipts are the same as exports, since they add to our balance of payments earnings and are extremely important to the total U.S. balance of payments position. The 1951 amendment to the Internal Revenue Code was intended, in large part, to encourage U.S. technicians to seek employment abroad, and the proposal to take away the exclusion would discourage such employment and, in our opinion, decrease receipts from technology transfer fees.

The value of Americans abroad is simply this: they insure that the United States gets its fair share-- or hopefully, more than a fair share-- of the existing foreign market for U.S. components in more sophisticated items not manufactured in the foreign country--heavy machinery or technical services. In ordering equipment, supplies, raw material of all types, replacement parts, etc., a U.S. citizen abroad is in a position to favor his country of origin, the United States. An estimated 10% of the U.S. employment force depends upon exports: by reducing the number of U.S. representatives abroad, we will drastically reduce exports, precisely at a time when our balance of payments deficit is worse than ever.

Examples

Let me give you a few specific examples, if I may, as to what Americans abroad mean to the United States exports of goods and services to a country such as Venezuela:

> (a) One of the nationalized oil companies in Venezuela is embarking upon a refinery expansion which, it is estimated, would cost from $850 million to $1 billion. It will involve 16 million man hours and approximately 4,000 people. The company that gets the job--hopefully, American--will have to put about 350 technicians and supervisory personnel into Venezuela, with a support team back in the United States. Most of that money--$850 million to $1 billion--will come to the United States for the purchase of equipment and services if we are not priced out of the market by the cost of U.S. personnel abroad.
>
> (b) The saleq of a leading U.S. earth moving equipment firm distributor in Venezuela were approximately $125 million

a few years ago. Household appliances sold by the same company amounted to $100 million. This company operated with a U.S. staff in Venezuela of 28 persons. These 28 persons generated $125 million in U.S. exports of new equipment, parts and services for earthmoving equipment and about half the value (in components from the United States) of $100 million in sales of household appliances.

(c) A U.S. contractor is building with local partners a dam in Venezuela for the Venezuelan government with 68 U.S. employees. The job is just commencing and $20 million in U.S. equipment have been imported to date. It is estimated that another $33 million will be imported within the next several years. The job itself will generate revenues of $150 million which hopefully, will produce a substantial profit for the American partner to be brought home. The estimated cost of maintaining these 68 employees abroad, if the 1976 Act version of section 911 is enacted, is between $300,000 and $400,000. That additional cost is what can make a U.S. company noncompetitive. If it loses the bid, it is needless to add that there will be no exports of U.S. equipment, and no profits will be brought home to help the balance of payments.

(d) Senator Proxmire from Wisconsin will, I hope, find the next example of particular interest. Racine, Wisconsin, as you know, is the headquarters for Johnson's Wax. In the supermarkets of Venezuela you will not find any imported household wax or insecticide products; all are made locally. Johnson's has a local plant and has the major share of the household wax market and a large portion of the home and insecticide market. If Johnson's had not established a plant and distribution system in Venezuela almost two decades ago with U.S. personnel, there would not be a nickel remitted to Racine, Wisconsin, in the form of equipment purchases or profits. This is a clear case of "Get in or get out."

These are simply four concrete examples. We could report many more.

The United States exports over $3 billion of goods and services to Venezuela per year. Venezuelan imports grew 61 percent from 1976 through 1979. Venezuela is the best market for U.S. goods in Latin America aside from Mexico and Brazil. We Americans cannot afford to lose it.

The Price Americans Pay to Work Abroad

Americans working abroad are working for America. We, the American Chamber of Commerce in Venezuela, representing most of the employed Americans in Venezuela, are not movie stars trying to take advantage of United States tax laws. Far from it. The truth of the matter is that we are simple American citizens who are both employees of large American businesses as well as traditional American entrepreneurs. Some of us came to Venezuela of our own free will; others of us were assigned here by our companies. Considering the personal and financial difficulties which many of us have had to endure as a result of our residence in Venezuela, it is unfair to inject into the tax laws a further penalty on those of us who are bringing profits to America by working abroad. We who work abroad are subject to privation and hardships which are unknown to the average American taxpayer. I would like to be more precise in stating what these hardships are, not to win you over by sympathy, but rather to demonstrate the true extent of our plight.

Inconveniences

We lead, in the United States, what is probably the most comfortable life in the world; we are the "affluent society." Telephones cover the nation, as do power facilities; the existence of laundries and dry cleaning establishments is taken for granted; service companies of every type abound; supermarkets and department stores offer every variety of food and merchandise at reasonable prices; no linguistic problems exist. In less developed countries, on the contrary, most or all of these goods and services are not readily available in the same quality, or are available only at prices which would make them luxury items in the States. We do not contend that all underdeveloped or developing countries are "hardship posts", but life for most people who work abroad is not as comfortable as in the United States and is considerably more expensive.

Venezuela is one of the more advanced third world countries. Nevertheless, it is woefully lacking in public services, even in the capital of Caracas, services that we take for granted throughout the entire United States. Last year the city of Caracas, with over 2-1/2 million inhabitants, was without water throughout most of the city for over 2-1/2 weeks. During the dry season -- which normally lasts six months of the year -- whole sections of the residential areas of Caracas are without water for days at a time. Garbage is dumped in the street in various sectors. Although the power service in Caracas is generally good, in the nearby industrial center of Valencia power interruptions often occur as often as five to seven times a day. A national shortage of power is forecast within five years.

Public transportation is virtually non-existent in certain areas, although a subway has been under construction for many years. Bus service is totally inadequate. Police protection is poor, since the police force is understaffed and woefully underpaid.

Education and Governmental Services

Educational facilities are, in general, inferior to or far more expensive than comparable schools in the United States. In Venezuela one has to make a choice whether to educate one's children in English or in Spanish. Very few children -- even those of the most humble families -- go to public schools if their parents can possibly make the sacrifice to send them to a private school. When I first went to Venezuela I was impressed by the fact that even the washerwoman at the boarding house where I first stayed sent her daughter to a private school, out of distrust for the local school system. Good schooling is expensive in Venezuela, whether the child goes toa Venezuelan or U.S.-style school. Many federal and municipal services, which we take for granted in the United States, such as interstate highways, sewage disposal, water, fire protection, etc., are not available or are woefully inadequate in many areas. To pay U.S. taxes, without receipt of such services from the U.S. government, also seems manifestly unfair.

Health

Medical statistics indicate that the less developed countries are not as healthy as the United States or Western Europe. The life expectancy is shorter, and U.S. life insurance companies apply a higher premium rate for those U.S. citizens residing in Latin America. Medical specialists and well-equipped hospitals are not as readily available. In Venezuela medical care is either poor or terribly expensive, and most Venezuelans who can afford it come to the United States for medical check-ups and treatment. There is clearly a health risk in living in many countries abroad.

Political, Security and Economic Risks

Many U.S. citizens living in Latin America have been through revolutions, attempted coup d'etats, street riots, etc. In many countries U.S. citizens living abroad are subject to physical danger and psychological terrorism. There is also the kidnapping threat. Two friends of mine have been kidnapped in Venezuela and one in Colombia, for combined political and monetary reasons. Many American executives are now required to have bodyguards. The psychological threat to wives, worrying over husbands and children, is such that in quite a few cases families have gone home. U.S. Citizens living abroad run the risk that their possessions and savings may be confiscated (Cuba) or devalued (most South American countries). What is earned in one year may be lost in the next.

Cost of Living

Food in Venezuela costs at least twice what it costs in New York, for example. We import about 50% of our food at the moment - and the consumer pays the freight. An apple in Caracas costs about one dollar. Vegetables are often hard to find, of poor quality, and at double the price.

As for housing, some is admitted quite luxurious. But housing equivalent to what the American overseas would have in the United States is costly - perhaps double that of New York City. Coupled with the lack of the ordinary services such as water, telephone, light, etc., life in Caracas is not as pleasant as in the United States.

The so-called big ticket items in Venezuela are terribly expensive....the automobiles cost 2-1/2 to three times what they cost in the States, as do most kitchen items. The local content is high - 43% in the case of cars - and parts are often of inferior quality, with a short life, and expensive.

Some comment should also be made with respect to the quality of life in Third World countries. With all due respect to local efforts, Venezuela simply does not have the cultural attractions available to U.S. residents - either in their own cities and towns or within easy travelling range. Even assuming the elimination of any linguistic problems through study and years of living abroad, we lack the museums, the theater, the concerts, the opera, even the cinema and television programs which abound in the United States.

Higher salaries in Venezuela are necessary as an incentive to compensate for high living costs, the economic and psychological dislocation ("uprooting") factor, greater political, security and economic risks, inconveniences and lack of governmental and other services taken for granted in the United States.

The argument has been made that U.S. companies should simply increase their remuneration to U.S. citizens abroad to prevent their flight back to the United States. This would increase significantly the cost of those corporations doing business abroad and, accordingly, make them less competitive in bidding on international contracts or in selling their products. As you know, the United States is one of the few countries in the world that taxes its citizens abroad on locally-earned income. In addition to this loss of potential future business for U.S. companies and exporters, many U.S. citizens abroad who generate export markets do not work for large U.S. companies; they work as entrepreneurs, or for foreign companies or for small businesses which cannot afford the additional costs required to keep the U.S. citizens in the same net after-tax position as his compatriot back home, since he must pay higher bracket taxes on the additional income, which in turn, requires additional pay, with an overall spiraling effect.

Estimate of Number of U.S. Citizens Living Abroad

It is perhaps worth adding one word about the discrepancy in figures between U.S. State Department estimates as to U.S. citizens living abroad and those of the U.S. Census authorities. Please note that "living abroad" does not necessarily mean "working abroad" and we are only advocating tax relief for those working abroad.

However, U.S. State Department figures as of June 30, 1979, indicated 23,000 American residents in Venezuela. This is simply not so. The U.S. Embassy in Caracas includes in this number everyone who has either registered with the U.S. Consulates in Venezuela or obtained U.S. passports in Venezuela during the last ten years; no information is available as to how many of these people died or have left Venezuela. This 23,000 is a ten-year comulative figure, reflecting, in the case of Venezuela, the highwater mark of the U.S. oil industry prior to nationalization of the oil industry. It also includes those persons of dual nationality - Venezuelans born in the United States or in Venezuela of one or more U.S. parents - who may be much more culturally identified with Venezuela than with the United States. During one brief period last year, the U.S. Embassy in Caracas estimated that almost 40 percent of the passports issued during a given time period, were issued to persons of dual nationality more identified with Venzuela than with the U.S. Hence these State Department statistics are woefully inaccurate as to the number of Americans residing abroad and cannot be used in making any estimates of revenue loss.

Complicated Reporting Requirements for U.S. Citizens Living Abroad

I would like also to comment briefly on the incredibly complicated forms that U.S. citizens residing abroad must fill out to obtain the limited benefits available under sec. 913. I am convinced that only the employee of a multinational corporation with the combined genius of the tax department of his parent company and that of an outside accounting firm can ever hope to fill them out correctly and in less than a week's time. Surely there must be a simpler method of calculating the tax liability, and an off the top exclusion would eliminate much of this paperwork.

To make my point, the IRS publication No. 54, revised in November of 1979, entitled "Tax Guide for U.S. Citizens Abroad" is 45 pages long of small print (This is an increase of one-third over the 1978 edition which was only 34 pages long). This does not, of course, include the instructions on how to calculate the foreign tax credit for U.S. citizens, which is contained in another 1979 publication (No. 514) which is a mere 24 pages long. Then we get down to the instructions on how to fill out Form 2555, in which the taxpayer calculates his deductions, if any, under section 913; this, through some oversight, is only eight pages long. Those who have struggled each year with the utterly incomprehensible (to the ordinary mortal) U.S. foreign tax credit regulations - and have concluded that they no longer understand the English language - will perhaps derive some solace from a recent opinion of the sophisticated U.S. Court of Claims. The Court, in referring to the foreign tax credit regulations, used such phrases as "the unknotted short pieces which we have patiently picked, one by one, from this tangled mass" and stated - as perhaps a masterpiece of understatement - that "the imprecise terms used in the attempt to regulate the foreign tax credit are a source of confusion".

Conclusions and Recommendations

It seems ironic that while the communists paint on the walls of many foreign countries "Yankee Go Home", there are many who by a short-sighted tax policy are perhaps unwittingly saying, "Yankee Come Home."

Our Chamber firmly believes that it is to the benefit of the U.S. balance of payments and to the maintenance of employment in the U.S. export industries that U.S. citizens be encouraged to live abroad and certainly not be penalized for working abroad.

Although "The Foreign Earned Income Act of 1978" granted special deductions for certain foreign living expenses and generally reduced the tax liability which would have been due under the "Tax Reform Act of 1976", the tax payments of U.S. citizens resident abroad are greater than they would have been under the legislation in effect prior to 1976. In addition, the extensive reporting requirements under the 1978 legislation have created difficult compliance burdens, with resulting high administrative costs.

We believe that a legislative solution is due this year which would allow U.S. enterprises to compete on equal terms with foreign firms, in addition to reinstating tax incentives for U.S. citizens working abroad. Any further Congressional delay for the purpose of additional study or evaluation of this issue would be unnecessary and detrimental to the global interest of the United States.

We strongly urge the Subcommittee to consider the adoption of a system of total exemption from U.S. taxation for all income earned abroad by U.S. citizens. This system would be consistent with a concept of taxing U.S. residents abroad on the basis of residency, a method followed by most industrialized countries. Should Congress decide that this approach, at least theoretically, is subject to abuse, then this method could be limited to a strict residency test. If Congress instead decides to support the general exclusion approach, then we urge the Subcommittee to adopt a flat exclusion in the range of dollars 50,000 to 65,000 with a $5,000 yearly increase in addition to an appropriate housing deduction.

they would have been under the legislation in effect prior to 1976. In addition, the extensive reporting requirements under the 1978 legislation have created difficult compliance burdens, with resulting high administrative costs.

We believe that a legislative solution is due this year which would allow U.S. enterprises to compete on equal terms with foreign firms, in addition to reinstating tax incentives for U.S. citizens working abroad. Any further Congressional delay for the purpose of additional study or evaluation of this issue would be unnecessary and detrimental to the global interest of the United States.

We strongly urge the Subcommittee to consider the adoption of a system of total exemption from U.S. taxation for all income earned abroad by U.S. citizens. This system would be consistent with a concept of taxing U.S. residents abroad on the basis of residency, a method followed by most industrialized countries. Should Congress decide that this approach, at least theoretically, is subject to abuse, then this method could be limited to a strict residency test. If Congress instead decides to support the general exclusion approach, then we urge the Subcommittee to adopt a flat exclusion in the range of dollars 50,000 to 65,000 with a $5,000 yearly increase in addition to an appropriate housing deduction.

Our Chamber feels that such a flat exclusion is equal to the amount granted in 1962 when the dollars 20,000 limit was enacted. This is so because since 1962 the Consumer Price Index has increased 162.7 percent and an equivalent amount in 1980 would be dollars 52,582. Accordingly, the dollars 25,000 exclusion granted in 1964 to U.S. citizens resident abroad for more than three years, would correspond to dollars 65,185 today.

We believe that the facts set forth in our statement firmly support our petition that tax relief and incentives be granted to U.S. citizens employed overseas in order to effectively maintain -- and further promote -- U.S. exports and commercial competitiveness abroad. We urge remedial action now!

Thank you very much.

UNITED STATES TAXATION OF OVERSEAS AMERICANS AND AMERICAN BUSINESS AND EFFECT ON U.S. COMPETITIVENESS IN HONG KONG

PRESENTATION

TO

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

SENATE FINANCE COMMITTEE

Hong Kong

July 4, 1980

Prepared by

Taxation Sub-Committee

International Affairs Committee *

The American Chamber of Commerce in Hong Kong.

* This statement has the endorsement of the ACCHK Board of governors.

TABLE OF CONTENTS

Summary & Background	Judith A. Tompkins
Position of the American Chamber of Commerce in Hong Kong	G. L. Bill Miller
Attachment A - Problems with Section 913	Matthew Kretzer
Attachment B - Some Problems with Attempts at Tax Equalization	Anne Shih
Attachment C - Rationale for Foreign Earned Income Exclusion	Philip B. Garrison
Attachment D - Hong Kong International School	David F. Rittman
Attachment E - Table of Merchandise Trade with Major Trading Partners	Hong Kong Department of Census and Statistics, Hong Kong Monthly Digest of Statistics, January 1979 and 1980.
Attachment F - Report of the Task Force to Study the Tax Treatment of Americans Working Overseas	Subcommittee on Export Expansion, the President's Export Council
Attachment G - Tax Problems of Independent Americans Abroad	I. H. Fredricks
Attachment H - Income and Tax Comparisons for U.S. and Hong Kong	Judith A. Tompkins
Attachment I - Principal Findings of Study on Economic Impact of Changing Taxation of U.S. Workers Overseas	Chase Econometric Associates Inc.

SUMMARY

The main points of the Hong Kong presentation can be summarized as follows:-

- *America needs Americans overseas to continue to develop international markets.
- *Current US tax laws place Americans at a tax disadvantage both as to 3rd country nationals and as to Americans at home.
- *There has been a substantial decrease in recent years of American employees in Hong Kong relative to 3rd country nationals.
- *It costs significantly more to maintain a US citizen in Hong Kong than it does a 3rd country national primarily because of the US income tax.
- *The Section 913 deductions enacted under the Foreign Earned Income Act of 1978 designed to place Americans overseas on a parity with those at home do not accomplish this goal much less make Americans competitive with other nationals.
- *Section 913 deductions are drastically reduced if an American overseas receives tax equalization payments or if both husband and wife work.
- *Because reimbursements for excess foreign living costs and tax equalization payments are considered additional income, effective tax on earnings of a working spouse are 50% or even more (due to the decreased housing deduction).
- *The heavy tax burden on working wives has generated a serious side problem for the only American standard school in Hong Kong in that the school now has difficulty in recruiting American teachers.
- *The Chamber believes the simplest solution to the tax/cost problem of employing US citizens overseas is to exclude foreign earned income from US income tax.
- *In the past few years, there have been attempts to change the current law in order to tax the profits of US-owned foreign corporations regardless of whether the profits are repatriated or not. Taxing profits not distributed is vigorously opposed as highly adverse to the ability of US-owned business to compete in international trade.
- *Concern is mounting over more and more restrictive IRS interpretation of what it will accept as a foreign tax credit against the US income tax. Appropriate efforts should be made to keep liberal tax credits to avoid double taxation.
- *Some of the DISC provisions should be liberalized, not restricted or abolished as is recurrently suggested, to provide incentives for US exports.

BACKGROUND

Hong Kong is a 404-square mile British Crown Colony with an estimated population of 5 million people located on the South China Sea within easy commuting distance of most Asian capitals. It is important as an Asian trade center, particularly with China, serving in major capacities both as a reexport agent and in financing. Hong Kong also has local industries, notably in textiles, plastics and electronics.

The main trading partner for Hong Kong is the United States. In 1979 of the 6 major trading partners the U.S. accounted for 50% of Hong Kong's domestic exports and 17% of its imports. While the U.S. marginally increased its 3rd place share (from 17% to 17.3%) among the major providers of goods to Hong Kong during the 5 year period of 1975-1979, Japan strengthened its #1 position by over 7% (from 30% to 32.2%). See Attachment E.

Hong Kong has few barriers to trade. It is a duty-free port for most items and local ordinances are not restrictive to trade or to business in general. Hong Kong thrives on competition through free enterprise. To operate in Hong Kong a business must be competitive.

Hong Kong derives revenues from a relatively simple tax system comprised of salaries taxes, profits taxes, interest taxes and property taxes. Applicable Hong Kong tax returns must be prepared, filed and taxes paid by all U.S. citizens or American businesses in Hong Kong. Basic characteristics of the 4 main taxes can be summarized as follows:

- Salaries tax. Graduated rates from 5 to 25% on salary less personal exemption with an overall maximum rate of 15% of gross salary. Because the top rate is reached at about US $8,000 most expatriates are subject to the 15% overall maximum.
- Profits tax. Effective tax rate is 17% (15 + 2) of net profit from Hong Kong operations after adjustment for a few non-allowable expenses.

- Interest tax. 15% withheld at source. Interest on bank savings accounts is exempt.
- Property tax. 15% of assessable value less 20% statutory allowance.

Please note that because the above are simplified for summarization the Ordinance should be referred to for specific provisions. Along the same concepts of simplification following is a partial list of types of income not generally taxable in Hong Kong:

- Dividends, regardless of origin
- Capital gains, unless a dealer
- Income earned outside of Hong Kong
- Interest and other passive income from sources outside of Hong Kong
- Rent refunds if complying to specified formula
- Holiday travel expense

All residents in Hong Kong are subject to the provisions of the Hong Kong tax ordinances but only Americans are also subject to income taxes in their country of citizenship on salaries earned in Hong Kong.

The working force in Hong Kong can be classified either as expatriate, generally being provided with some kind of incentive package, or as local hire.

Informal queries indicate the expatriate package for all nationalities generally includes rent relief from the extremely high rentals for apartments in Hong Kong, home leave allowances and schooling allowances for children. In addition a large number of American firms provide their American expatriate employees with some kind of relief from additional individual income taxes as compared to what employees at the same level pay in combined state and Federal taxes in a designated state--usually the corporate headquarters state.

Tax equalization, required only for Americans, can be substantial and is the direct cause of an American employee costing more to his company than a similarly qualified employee from Europe, Canada or other third country. It should be noted that tax equalization is in the form of tax payments to the U.S. government, whether direct or reimbursed, and do not benefit either the company or the employee even though the amount is then added to the employee's reported compensation and subsequently taxed. Most tax equalization payments are required to make the tax treatment the same as in the states. Therefore without tax equalization most Americans are now refusing to accept transfers to Hong Kong as they suffer a dramatic reduction in standard of living.

Workers on local hire in Hong Kong are entitled to very few benefits and the wage scale is substantially lower than that for expatriates. In general Americans have difficulty competing for local hire jobs because they do not have local language ability where Cantonese is required as well as English.

Those possessing special skills or having backgrounds in areas not yet developed in Hong Kong can find jobs but generally at salary levels lower than comparable U.S. pay. For the single individual or head of household this again generally means a lower standard of living. But for a working spouse the result can be a marginal or even a negative net income if child care or significant other job-related expenses are required.

A working American couple in Hong Kong where the husband is earning $25,000 and the wife $11,000 can easily find that the effective tax rate on the wife's earnings is 45% (see Example A-2 in Attachment H). The example shows an additional tax due of $5,193 resulting from the additional $11,000 income. If this same couple were in the U.S. the increase in tax would be $3,663 for the wife for an effective rate of 33%. The examples show how Section 913 has severe negative impact on the take-home pay of a working American spouse relative both to similar couples in the United States and to couples of other nationalities in Hong Kong.

The direct result of the additional U.S. tax burden, whether it is shouldered by the employer or borne by the employee, is an exodus of American workers from Hong Kong. An additional important side effect is the inability of companies who want and need American employees to recruit Americans at all. This latter phenomenon has particularly been felt by the American-standard school in Hong Kong (see Attachment D).

Following are papers dealing more in depth to the points here mentioned.

POSITION OF THE AMERICAN CHAMBER OF COMMERCE IN HONG KONG

With China Trade on the brink of rapid growth America cannot afford to decrease the presence of U.S. businessmen in Hong Kong, the vital link to such trade. We believe it is crucial to United States interests to have U.S. citizens working and residing abroad. A few important reasons for this are as follows:

1. Valuable personal experience in handling international business is gained through overseas assignments. The personal relationships developed and local knowledge acquired cannot be duplicated in any other way. Future business managers need this kind of experience if they are to guide U.S. business in the competitive international world in which we live.
2. Decreased numbers of overseas jobs for Americans could have a devastating snowball effect on U.S. business overseas. With little or no opportunity to work abroad most young Americans would not make the extra effort needed to learn foreign languages, study international business and enter into international careers. As less and less overseas jobs are available this trend could rise geometrically and seriousl diminish future U.S. capabilities in international commerce.
3. The number of Americans employed overseas by non-U.S. related companies has decreased substantially in recent years. The lack of such employment not only increases the impact of the

concerns mentioned above but also eliminates an important source of U.S. sales. That is, American managers tend to buy American whenever possible while third country nationals understandingly favor purchasing products of their home country. American engineers employed abroad in plant design and industrial planning tend to provide specifications for U.S. manufactured equipment and processes for use in projects because those are items with which they are most familiar.

Given the importance of having Americans employed overseas what has been the recent trend in Hong Kong? A large U.S. company with regional headquarters in Hong Kong provides the following statistics:

Of the total expatriate employee population in Hong Kong during each of the last three years the percentage of Americans VS. third country nationals has been smaller. Special note should be made that not only is the percentage smaller but is decreasing each year.

Year ended	Percentage of expatriate population in Hong Kong who are Americans
1977	49%
1978	37%
1979	35%

By the end of 1980 the company expects this figure (on a regional basis) to be around 25%.

/2

The percentage of Americans in the total Hong Kong expatriate population of another company again shows a decreasing trend over the past few years.

Year ended	Percentage of expatriate employees in Hong Kong who are Americans
1974	60.4%
1975	57.7%
1976	57.4%
1977	52.0%
1978	49.0%
1979	45.1%

The expected future situation is a continuing percentage decrease. A recent study of non-executive salary costs by this company demonstrates the cost differential between a Hong Kong based American expatriate employee and a third country national employee.

Cost for U.S. expatriate	$138,000
Cost for third country national	94,000
Cost differential	$ 44,000

This means that they could hire three TCN'S for the cost of two American expats.

The reason for the decrease in the relative numbers of U.S. citizens working overseas is simply a matter of cost. It in fact, costs more to maintain an American expatriate employee overseas than it does for a third country national employee. The primary item in this cost differential is the U.S. income tax. No other major country in the world taxes its citizens on their earnings while resident outside of the home country. This

/3

means that for an American employee to receive the same net pay as a competing third country national his gross pay package must be higher. Since the employer has the option to hire equally qualified expatriates, one of which will cost more, he cost justifies hireing the third country national. Of course, the company that hires no Americans has much lower costs to recover and can be more competitive.

The initial cost differential outlined above is high enough as it is, but when all the taxable allowances are added to the base salary figure the compensating allowance (sometimes called a tax protection allowance) becomes a very large figure. Because this compensating allowance is itself subject to tax when received in the following year it becomes increasingly larger and larger until in some cases it ultimately exceeds the employee's base salary plus other allowances. This is the pyramiding effect of tax reimbursement programs that is often referred to.

Another consideration inter-connected with the whole U.S. expatriate cost problem in Hong Kong is the working wife. As you know, more and more U.S. families have both spouses working and the wife expects to continue her career even if the husband is transferred overseas. Under prior law this was very beneficial in that each spouse was allowed a separate exclusion and the wife's income was usually within this amount. This provided added incentive for working families to accept overseas assignments.

/6

However, under current law the wife's income is subject to the very high incremental rates on the joint return and is often taxed at the 50% maximum rate for earned income. There is therefore no incentive for working spouse families to accept overseas assignments. This has increased the already difficult problem of recruiting for overseas duty.

This additional tax burden on working spouses has created another problem in providing American Families here in Hong Kong with adequate U.S. type school facilities. Many of the teachers in the Hong Kong International School have traditionally been drawn from the working spouse population. As is pointed out in Attachment D, The headmaster is having a difficult time coping with this new problem.

We realize that the Foreign Earned Income Act of 1978, by enacting Section 913 of The Internal Revenue Code, was congress' attempt to ameliorate the tax effect of the higher costs of maintaining Americans in overseas locations like Hong Kong. However, as detailed in our Attachment A, this effort falls short of accomplishing that goal. Moreover, the Act provided no relief for the extra costs of tax protection and its sinister pyramiding effect mentioned above. (See further comments on this matter in our Attachment B).

Furthermore, the present deductions available under Section 913 of the code do not attempt to solve the basic problem in the competitiveness area; that Americans overseas still pay U.S. tax on their earned incomes while third country nationals are

/5

not taxed by their home countries (See Attachment C & F). Until this basic problem is eliminated Americans will continue to carry an extra burden with them to any overseas employment situation.

How this problem is to be eliminated has been the subject of much discussion and controversy. In the long run the most controversial may be proper route to take; that is, the complete exclusion of all foreign earned income by qualifying persons. This position has already been introduced in the house last year by Representative Frenzel in his bill, H.R. 5211, and we support this forward thinking proposal.

Other persons, while favoring the theory of full exclusion for the overseas employee, hesitate to support full exemption for all. However, they might agree with a system with high enough limits to accomplish virtual full exclusion for such employees and at the same time prevent possible abuse. This thinking could have been behind recent advice to President Carter by his own economic counsellors that the taxing of overseas Americans was counter to U.S. interests and recommended an exclusion of $65,000 per year for bonafide residents of foreign countries.

Of course the best evidence of this theory carrying congressional favor was the passage of H.R. 13488 by the House of Representative, with a great majority, on September 25, 1978. This bill recognized the need for eliminating taxation on high overseas costs, through a series of deductions, and also recognized the need to provide incentives for U.S. citizens to accept overseas assignments, through an additional exclusion. Representative Ullman in his report on the bill stated,

> "The committee believes that an exclusion from income, in addition to the deductions for excess foreign living costs, is necessary in order to compensate fully U.S. employees working abroad in areas other than Canada and Western Europe for the hardships they must endure and to encourage U.S. citizens to accept employment in those areas. The presence of U.S. citizens working abroad encourages the purchase of U.S., instead of foreign, goods and services, and, therefore, the incentive provided by this bill will produce substantial benefits for the U.S. economy. In addition, the presence of U.S. citizens working abroad provides considerable noneconomic benefits, such as enhanced international goodwill and mutual understanding."

If congress would give some more thought to the concepts and ideals put forth in H.R. 13488 they should soon agree on a new law eliminating taxation on foreign earned income of Americans overseas. We urge them to do this as soon as possible so America can move forward and again become competitive in the international market place.

Unfortunately, H.R. 13488 was not passed in the above form but was altered substantially into the law we now have. Such altering took place at last minute sessions and appears to have been largely influenced by budgetary considerations. Revenue loss figures were computed and recomputed constantly and probably had more bearing on the changes than any long-term consideration. If such revenue calculations had indeed such import we hope they were accurately computed and could stand up under audit. One expense factor hopefully considered was the great amounts of time and money spent on compliance procedures necessary to implement and police the new law; both from the private and government sectors.

After thinking over all the above we cannot help but go back to supporting Representative Frenzel's simple approach to this problem through his H.R. 5211 bill which would then leave the business sector to its task of making sales and profits and the IRS could go after the one hundred billion dollars in unreported income, as reported in the September issue of The Washington Report, instead of spending millions trying to administer the Foreign Earned Income Act of 1978.

Another problem concerning U.S. business here in Hong Kong is the U.S. Tax treatment of profits derived from doing business in China.

Such treatment will have a great deal to do with their competitiven for China trade. The two major points of concern are; (1) whether the U.S. will continue to tax the profits of U.S. owned foreign subsidiaries only as they are repatriated and (2) whether Chinese taxes imposed on the foreign subsidiary will be creditable against U.S. taxes upon repatriation. For example, let us look at the following figures:

	U.S. owned subsidiary	Foreign owned subsidiary
Net profits of China business before Chinese tax	100	100
Assume 20% Chinese tax	(20)	(20)
NET RETURN	80	80

At this point the U.S. owned business and the foreign owned business are competitive. This is the case under current U.S. Law and no further U.S tax would apply until repatriation. However, during the past few years there have been efforts to tax the profits of U.S. owned subsidiaries even if such profits have not been distributed. Any such attempts to change the current law should be opposed vigorously as such a change would be very adverse to the competitive position of U.S. owned business operations.

The concern over the tax credit stems from recent moves by the Internal Revenue Service to limit and restrict what they consider to be a creditable foreign tax. Recently proposed regulations in this area do more to confuse the issue than clear it up. China does not yet have a clearly defined income tax and the concern would be that whatever they do draft in this area might not coincide with what the IRS considers a creditable tax. Applying this to our example the following could result upon repatriation of the subsidiaries' earnings.

	Chinese tax qualifies as creditable tax	Chinese tax does not qualify for credit
Dividend income	100	80
U.S. tax (46%)	46	37
Foreign tax credit	20	0
NET U.S. TAX	26	37
TOTAL TAX BURDEN RATE	46%	57%

If the IRS rules and regulations are not opposed by congress soon, it is possible that U.S. companies cannot be competitive in upcoming China Trade.

Additionally, there have been recurring suggestions that the DISC provision be abolished from the law or severely restricted. We can only point out that DISCS, even in their present form, could be a powerful force in future China trade and the law should at least be retained as presently constituted, with a future thought to liberalizing some of its provisions.

In fact, expanding the DISC rules could be a quick and easily implemented export incentive. The basic legal framework is already there and only needs liberalizing to create more incentive for export trade. For example, the percentage of untaxed income could be increased up to 100%. Furthermore, while DISCs have drawn criticism from other trading countries, they have not yet been proven to be a violation of GATT. Incentives in the form of direct export credits might not be able to avoid such a violation.

Another form of tax incentive to exports would be the reduction of dis-incentives now in the law. For example, Section 904(f) of the Internal Revenue Code provides that when a taxpayer has an overall foreign loss for a particular year, he must recapture this loss in future years via a reduction in his foreign tax credits. Taxpayers establishing sales operations outside the United States may very well have losses in the early years and allowing them current deductions without a subsequent penalty would provide more incentive to establish such operations.

SUMMARY:

We need Americans overseas for the present and future good of the country.

The present structure for taxing foreign earnings of U.S. citizens runs counter to this need and requires revision.

The simplest and most direct method of accomplishing this is to provide full exclusion for the foreign earned income of Americans overseas.

To assure competitiveness of U.S. owned enterprises overseas the deferral concept, DISCS, and a liberal foreign tax credit should be continued.

ATTACHMENT A

PROBLEMS WITH SECTION 913

When a US citizen accepts employment abroad he is generally faced with a higher cost of living. In order to compensate for that higher cost of living the employer must generally offer the US citizen a higher income. The extra income is meant to compensate the employee for the extra costs he will incur as a result of living abroad. In this sense the extra income is not income at all but merely brings the US citizen up to the same standard of living he would enjoy in the US on the lower income. Under US tax law all income is taxable unless specifically exempted. Consequently reimbursement of the excess costs of living abroad is seen as taxable income even though it represent no real economic gain to the employee. As the employee's taxable income is increased, so is his US tax liability. Section 913 was written to ameliorate the increase in tax liability of US citizens working abroad which is caused by this artificial increase in taxable income. It is structured to give deductions for the excess costs of working abroad and thereby reduce the expatriate US citizen's taxable income to what it would be had he not been working overseas. In short, the purpose of Section 913 is to take away the difference in tax liability between US citizens working at home and abroad whose real economic income is equal. Section 913 falls considerably short of this goal. Furthermore, Section 913 is needlessly complex. This paper will examine a few of the major problems with Section 913 and show how they fall short of the goal of tax equalization.

Schooling expense:

Section 913 (f) allows a deduction for "reasonable schooling expenses". Paragraph (4) of that subsection limits deductible expenses to those which would be incurred at the least expensive "adequate US type school within a reasonable commuting distance." Naturally the IRS has given tentative definition in the proposed regulations to Section 913 of "adequate US type school" and "reasonable commuting distance". There appears to be no reason for the IRS to have to rule on these two concepts. Parents want their children to go to the best schools possible and they want them to have the shortest commuting time possible. Whoever is paying the bill, be it the parent or his employer, wants the lowest price possible. These interests will naturally check each other to insure that the most reasonable balance of quality, distance and price will be chosen. The tax deduction merely reduces the cost of education for an expatriate's children by the tax effect of that cost. Much of the cost of the education still remains and will always be of prime consideration.

Home leave travel expenses:

Section 913 (g) allows a deduction for the "reasonable" amounts paid for the "transportation' of the taxpayer and his family from his overseas tax home to his "present (or, if none, most recent) principal residence in the United States .. and return".

The first issue once again is what is "reasonable". The IRS has already defined first class travel for home leave to be unreasonable in the proposed regulations. Once again it must be argued that the person who pays the bill should decide what is reasonable. Cost, not tax effect, should be the deciding factor. Some company policies and individual circumstances may make first class travel quite reasonable. The IRS does not exclude first class travel from the bounds of reason for business trips, why for home leave?

The next question is why only transportation costs are allowed. At least meals and lodging en route should be deductible, and a strong case can be made for allowing a deduction for living expenses while on home leave. One of the costs of living abroad is that after returning on home leave one must very often live in hotels and eat in restaurants. It would not be unreasonable for the law to allow a deduction for these expenses for a specified period.

Why should home leave transportation be limited to the present or most recent US principal residence? The present principal residence is generally overseas and the most recent principal U.S. residence may be quite irrelevant. Once again the price of travel within the US will act as deterrant enough to excessively long trips without adding on the tax effect. The transportation allowed should be to any place in the U.S.

Section 913 (g) (1) has been interpreted to mean that transportation of a college student dependent of the taxpayer to the overseas tax home and back to college in the US does not qualify as home leave because of the sequence of the trip. This is an unnecessarily restricitive definition of "home leave". The cost of transportation of one's children from college to the foreign tax home is undeniably a cost of working abroad. Why not allow a deduction for this expense?

Finally a home leave deduction should be allowed for situations of family emergency such as death or serious illness of a family member.

Cost of living:

The government cost of living tables and private tables are all based on the same theoretical comparison of a market basket of goods in the US and the foreign location. It is unclear why there is such a large difference between the government tables and private tables, but there is. In many cases the private table which an employer uses allows many times the cost of living allowance which the government table gives a deduction for. Employers are not interested in artifically inflating salaries so one must assume that they believe the private table to be an accurate approximation of the excess cost. The IRS tables should therefore be liberalized at least enough to be comparable to the privately used tables put out by independent rating services.

Housing:

The deduction for the excess cost of housing is the difference between the actual housing costs and the base housing amount. The base housing amount is 20% of earned income less deductions attributable thereto, including the other Section 913 deductions, and the total housing costs. The base housing amount is supposed to approximate what a family would pay for housing in the U.S. It is thought that the average family spends about 20% of its earnings on housing. However, because the other components of the Section 913 deduction are inadequate, the earned income from which the base housing amount is computed is larger than the individual's actual base salary. The base housing amount is correspondingly overstated, and the housing deduction is therefore too small. If the taxpayer receives a tax equalization payment because of high foreign taxes or because of the inadequacy of the Section 913 deduction, his earned income is artifically raised even further and his housing deduction lowered more. And if the wife works, even though her income would probably not be used for housing in the US, it will of course be added into the earned income for computation of the base housing amount, further reducing the deduction.

This unrealistically low housing deduction is especially disturbing to many expatriates because by going overseas they give up the only major tax break they previously had -- the deduction for mortgage interest and real property taxes associated with their home. Overseas most must rent.

Qualification requirements

Most American working abroad can easily meet either the physical presence test or the bona fide residence test. However some cases arise where the taxpayer manages to fail both tests even though he is definitely bearing the excess costs. This is especially true for those who come over on relatively short assignments. If a person is sent to Hong Kong for one year or eighteen months he will doubtlessly move his family over and bear the full brunt of the excess cost of living in Hong Kong. However he could very easily fail both qualifying tests. If he is here less than 510 days in total or takes his vacation and a few business trips in the US he will fail the physical presence test. If he stays for one year and 363 days he could fail the bona fide residence test by moving here on January 2 and leaving on December 30 of the following year. Even if he has been here a full calendar year and had his family with him the entire time it may be difficult for him to argue that he did not come for a definite limited time to accomplish a specific objective and therefore does qualify as a bona-fide resident. These requirements had some merit under the old $20/25,000 exemption law because the exemption was not tied to specific costs. With the Section 913 deductions directly tied to costs, however, there is no reason to keep these qualification requirements. If the taxpayer can show that his tax home is overseas and he is bearing the deductible costs there is no reason to impose any further requirements on him. The physical presence test and the bona fide residence test are not generic to the Section 913 deduction and should be done away with.

Summary

Throughout this discussion with reference to any individual deduction one could raise the objection that the law must lay down strict rules as to what qualifies for the deduction because otherwise it is too easy for the taxpayer to take deductions for expenditures which are not related to the excess cost of living abroad but which are basically personal. At first glance this argument has some merit. For instance more taxpayers would doubtlessly be tempted to fly first class on home leave if it was deductible. However the prime consideration will continue to be the price of the first class ticket rather than the deductibility. This is true with respect to all the deductions. There is no reason for the government to step in to these areas and judge on the reasonableness of the taxpayer's choice. There is little room for manipulation. No one is going to move overseas just to take advantage of the Section 913 deductions. These deductions should be viewed much as any other business expense and should be governed under the same general principles of "ordinary and necessary" which govern such other business expenses under Section 162.

Furthermore US policy towards taxation of its citizen working abroad should be to encourage not discourage them. No other major country taxes its expatriates on their earnings while resident outside of the home country.

The final burden of the costs of living abroad may be borne by the individual taxpayer or may be borne by his employer. In either case these costs have a great effect on how many Americans will work abroad. If an individual does not have a compensation package that specifically reimburses him for the excess US tax cost of living abroad he must ask for a significantly higher salary to compensate. If he is competing with local persons or with third country nationals he is at a great disadvantage because his after tax income will be significantly lower than theirs. If he is reimbursed by his company for the excess tax cost, the company will be competitively handicapped.

The US must decide whether it wants its citizens to work abroad and to compete in overseas markets or not . If it does it must try to eliminate the competitive disadvantage which US citizens and businesses face by virtue of US tax laws. Even if Section 913 worked perfectly to eliminate the artifical increase in income of Americans overseas they would still be at a disadvantage because Americans have to pay a higher percentage of their salaries for taxes in Hong Kong than local and third country nationals do. To increase the tax burden of expatriate Americans beyond what their US based equivalents pay can only be interpreted as the US's desire to inhibit US competition in world markets. We must face up to the fact that we need to encourage our international business capabilities, not discourage them.

ATTACHMENT B

Some Problems with Attempts at Tax Equalization

The Foreign Earned Income Act of 1978 was enacted by Congress in recognition of the high living costs experienced by U.S. taxpayers residing and working overseas. It was designed to place U.S. expatriates on parity with Americans living and working in the U.S. However, it has not accomplished these goals and, in fact, the act has caused severe adverse effects on U.S. expatriates, and will be detrimental to U.S. busineesses abroad, and to the U.S. economy as a whole.

The U.S. taxes its expatriate citizens on a worldwide basis, and is the only developed country in the world to do so. Moreover it taxes all income, including cash and non cash allowances the employee receives from his employer, whether or not the employee benefits from them. An example of this is the tax equalization/protection payments which an employer may pay to or for the expatriate in recognition of the fact that the employee pays more taxes while overseas than if he remained in the U.S. These payments are considered income even though the employee derives no direct benefit from them.

Since the U.S. taxes all income, cash and non cash, the income of the expatriate working spouse is consequently taxed at higher rates. Most of them find that at least 50% of their income will go to taxes. This is a staggering amount! The tax laws certainly offer no incentive to the overseas working spouse with the result being that few U.S. employees will be interested in transferring overseas where both husband and wife are working.

The Foreign Earned Income Act attempted to reduce the adverse tax effects on benefits the expatriate receives because of the higher costs associated with living overseas by providing limited deductions for home leave, education, cost of living and housing. However, these deductions do not by any means place the expatriate at the same level of

/2...

taxation as that of the American working and residing in the U.S.A. who receives a comparable base salary. One reason for this has already been alluded to above: tax equalization payments are considered additional income.

Another reason is due to the manner in which the housing deduction is calculated: the expatriate's total earned income (including tax equalization payments) plus earned income of his working spouse, net of a single set of deductions for home leave, cost of living, education and of housing expenses is used in the computation. Only those housing expenses in excess of 20% of the resulting net figure are deductible. As a result, the housing deduction is calculated on an artificial basis: it assumes that tax equalization payments and reimbursements for excess foreign living costs are freely spendable amounts in the taxpayer's hands.

In addition, use of 20% as a threshold for determining the amount of housing expenses which are deductible, is based on incorrect assumptions. It assumes that each taxpayer necessarily spends 20% of his income on housing. Moreover, since the working spouse's earnings must also be used, the IRS assumes that the spouse's earnings are necessarily spent on housing. Even if the assumptions were correct, it is more probable that expenses incurred in the U.S. would be in the form of mortgage payments, almost all of which would be deductible. For the expatriate, home ownership overseas may not be an option because of the laws of the country, because of the shortness of the assignment, or as in Hong Kong, the extreme high cost.

Other reasons why the expatriate's net compensation after deductions for living overseas is higher than it would be if the expatriate were in the U.S.A., are that there are no deductions for overseas incentives, and that the cost of living deduction is often less than the excess cost of living reflected in the cost of living allowance paid by the employer. In fact while most companies have increased the cost of living

best copy available

allowance for 1979 for their employees in Hong Kong, the 1979 Cost of Living Tables recently issued by the IRS show that the cost of living deduction for those living in Hong Kong has been cut by more than 50%. In 1978, the cost of living deduction for a family of four was $1,700. In 1979 it has now been reduced to $800.

In addition, the Foreign Earned Income Act does not provide for certain inequities the expatriate faces:

1. He may be subject to double taxation where the tax rates of the foreign country are higher than that in the U.S.

2. U.S. expatriates may be subject to certain non-income taxes which are not deductible or creditable. One example of this is the value added tax.

3. Contributions made to foreign charities are not deductible.

4. A taxpayer who wishes to appeal a tax controversy to the Tax Court may find himself without a forum, or he may be forced to go to the U.S. Tax Court in the District of Columbia.

Moreover, the tax system discourages the smaller companies from expanding abroad. While they may be willing to compensate their expatriate employees for the financial burdens of living and working abroad, they may not be able to compensate the expatriate for the additional taxes he must pay. In addition, the pyramiding effect of tax on tax payments renders hiring the American expatriate cost prohibitive.

Since most expatriates find that the deductions for living overseas are less than the old exclusions of income, with

/4...

the result that their tax bills are higher, those whose companies do not offer a tax equalization/protection program are reluctant to remain overseas, or to accept overseas assignments.

Those companies which do have tax protection programs are now less willing to hire American expatriates because of the added tax costs involved. Therefore many companies are turning to third country nationals. This adversely affects U.S. exports since third country nationals, being less familiar with U.S. products, naturally favour products from their own countries.

Furthermore, fewer Americans abroad could cause the U.S. to become more parochial, and less open to new and different ideas. This increases the danger that the country may become more isolationist.

Therefore the U.S. should offer, rather than decrease, tax incentives to U.S. companies and U.S. expatriates who are promoting U.S. interests abroad.

ATTACHMENT C

RATIONALE FOR FOREIGN EARNED INCOME EXCLUSION

The current state of the U.S. tax law is such that the U.S. citizen no longer has any incentive to move overseas. Section 913 of the Internal Revenue Code attempts to put U.S. citizens living overseas on an even basis with U.S. citizens residing in the U.S. Although under limited circumstances an exclusion of income is available, the majority of citizens living overseas can only hope that, at best, they will only be able to keep their income tax down to the level it would have been in the U.S. This creates a situation where fewer and fewer U.S. citizens will move overseas.

In the past the U.S. generally enjoyed a huge lead in technology over most other nations. Along with this, it followed that U.S. citizens were better equipped to handle this technology as managers and technicians. Foreign corporations, as well as U.S. multi-national corporations who were in need of this technology, created a demand for U.S. citizens overseas even though the resulting costs might have been higher than those for a local citizen or a third country national. As the technology gap decreased, the demand and necessity for U.S. citizens abroad also decreased. As foreign technology and related products become more competitive with our own, the added cost burden which the U.S. tax system imposes on American technology, with its need for U.S. citizen managers and technicians, has had a telling effect on our competitiveness overseas.

Most countries, other than the U.S., do not tax their citizens on overseas earnings. The former exclusion from income that has been in the U.S. tax law in one form or another since 1926, attempted to allow U.S. citizens to compete under these conditions. Because of this exclusion U.S. citizens were able to work oversess without requiring a larger salary in order to maintain the same standard of living they had back in the States. The main reason that a full exclusion was changed to one with a ceiling (such as the former $20,000 or $25,000) was because Congress did not want to allow certain individuals who received larger amounts of compensations, such as actors and actresses, to work outside the U.S. just to avoid all income tax. At the time the original $20,000 exclusion ceiling was set (1953) Congress felt that the majority of individuals overseas would have all of their income excluded.

Between 1953 and 1977 the $20,000 exclusion level, although undergoing slight modifications, generally stayed constant. In 1978 Congress passed the Foreign Earned Income Act which drastically limited the number of individuals that were able to exclude income and instituted Sec. 913 containing a new set of specific deductions.

While the $20,000 exclusion remained constant the world economy did not. The original intent of Congress, to exclude the lion's share of most businessmen's foreign earned income from U.S. taxation, was slowly eroded by inflation to the point where many U.S. expatriates had a better tax result under the deduction of Sec. 913 which were only designed to make them even with other U.S. citizens.

The point is that if we believe having U.S. citizens resident overseas is important in terms of balance of trade or other economic and social considerations then the U.S., as a country, must provide the means to allow them to compete with citizens of other nations. This can be accomplished by leaving Sec. 913 as it stands and reinstituting the exclusion of foreign earned income in whole or in part. Unfortunately, the proper exclusion amount that would eliminate most businessmen's taxes is hard to determine. One method might be to inflate the 1953 amount of $20,000 into today's dollars. This may not be valid because of other considerations such as the benefits of Section 913 and the inflation rates outside of the U.S. In any case a reasonable number would be far in excess of $20,000.

It is generally felt that given the chance, U.S. citizens can make great strides towards helping the U.S. accomplish its foreign economic goals. However, in order to do this they must be allowed to compete in the foreign market. They cannot do this under the current tax structure. Therefore, Congress should re-examine its reasoning behind the initial foreign income exclusion rules, which now appears to have been very incisive, and provide an incentive in the form of tax exclusion for residents abroad. If this is not done, the U.S. will increase its noncompetitiveness overseas and thereby create further havoc for the U.S. economy.

ATTACHMENT D

Hong Kong International School

David F Rittmann
Headmaster

6 South Bay Close, Repulse Bay, Hong Kong
Cable HKISCHOOL Phone 5-92305

December 3, 1979

Ms Judy Thompkins,
Security Pacific Credit,
Bank of Canton Building, 5th Floor,
Hong Kong.

Dear Ms Thompkins:

re: AmCham committee studying the impact of U.S. tax legislation on overseas employees.

The current tax law, in eliminating the previous $20,000 exemption for workers in US-related charitable organizations, is likely to have significant effects in the long run.

Of our professional staff of 110, sixty-five are working wives of men brought here by U.S. companies. Filing joint returns with their husbands, these women are invariably assessed in the 50% bracket because of the husband's salary level. Formerly the wife's income was exempt since our salaries are below the exemption permitted.

The net effect is withering: Sixty-five of our teachers here have taken significant cuts in pay; recruitment is now much more complicated. We already are anticipating salary raises to compensate for the loss - though that's almost counter-productive as the tax rate remains.

Because many teaching wives will not work under this tax situation, we are also faced with recruiting more non-Americans (we're an American school) and recruiting a larger complement of Stateside teachers to maintain our professional standard. This latter course is vastly expensive, further pushing up tuitions and the costs to Americans trying to do business overseas.

From countless admissions interviews with parents, I know an American school of high standard is vital for executives to consider a location overseas. For that reason our costs will go up as we try to offset the negative effects of the tax situation. The misfortune is that the added costs to all concerned will go toward maintaining the current quality rather than be channelled into programs and people that would improve our children's education.

Sincerely yours,

David F Rittmann,
Headmaster.

A Christian private school serving the American and international communities.

ATTACHMENT E

EXTERNAL TRADE

5.5 MERCHANDISE TRADE WITH MAJOR TRADING PARTNERS

$ million

	Imports						Domestic exports					
Year/month	Japan	China	U.S.A.	Taiwan	Singapore	U.K.	U.S.A.	Fed. Rep. of Germany	U.K.	Japan	Australia	Canada
	(20.4%)	(14.1%)	(10%)	(8.5%)	(8.0%)	(7.4%)	(46.6%)	(9.1%)	(13.5%)	(6.1%)	(6.5%)	(4.9%)
1975	6 991.13	6 804.94	3 980.76	1 943.53	1 928.08	1 7'3.41	7 333.31	2 039.02	2 777.51	936.12	1 033.33	773.22
1976	9 348.36	7 761.19	5 308.95	2 656.63	2 316.74	1 832.51	11 236.39	3 994.99	3 283.87	1 480.48	1 368.00	1 393.89
1977	11 347.31	8 061.89	6 093.13	3 231.74	2 888.49	2 191.98	13 331.92	3 660.91	3 034.53	1 386.14	1 247.12	1 171.17
1978	14 484.74	10 540.77	7 519.28	4 237.34	3 319.33	2 973.23	15 134.31	4 428.48	3 830.77	1 831.86	1 494.33	1 271.40
1977: Dec.	1 113.70	680.33	549.86	314.76	228.83	326.27	1 387.73	484.15	401.34	116.01	107.48	96.13
1978: Jan.	814.06	621.49	470.09	266.67	231.43	152.87	994.40	266.98	314.15	119.64	112.86	84.62
Feb.	952.14	569.66	475.27	220.01	204.66	191.04	743.80	229.28	166.01	78.20	77.38	68.32
Mar.	1 101.08	744.62	671.40	313.66	279.40	183.13	1 047.25	307.76	237.23	131.43	94.75	98.79
Apr.	1 149.81	775.84	676.13	327.63	267.52	236.44	1 212.77	302.09	283.64	117.40	96.75	97.42
May	1 172.89	820.40	664.93	340.90	237.64	207.81	1 362.76	373.41	324.34	134.48	97.09	117.83
June	1 136.82	839.23	686.14	333.49	207.96	263.79	1 309.78	333.53	299.96	125.47	111.49	113.83
July	1 220.36	789.81	543.89	337.18	300.67	310.25	1 361.87	399.09	338.83	140.12	127.85	101.39
Aug.	1 196.36	919.35	674.47	368.11	285.24	242.74	1 338.90	430.18	378.27	183.03	137.72	118.19
Sept.	1 263.37	1 025.06	693.85	373.19	283.84	240.14	1 331.47	383.24	387.33	218.11	141.27	112.91
Oct.	1 234.63	1 098.21	625.86	400.56	300.09	294.87	1 369.43	383.83	387.59	211.49	168.48	107.27
Nov.	1 408.33	1 113.97	719.49	424.77	279.11	309.03	1 334.67	442.27	389.24	221.41	173.90	123.09
Dec.	1 412.46	1 122.71	698.96	491.84	329.74	292.39	1 473.87	523.77	434.84	199.28	131.38	138.29

EXTERNAL TRADE

5.5 MERCHANDISE TRADE WITH MAJOR TRADING PARTNERS

$ million

	Imports						Domestic exports					
Year/month	Japan	China	U.S.A.	Taiwan	Singapore	U.K.	U.S.A.	Fed. Rep. of Germany	U.K.	Japan	Australia	Canada
1976	9,348.26	7,761.19	5,308.95	3,056.63	2,316.74	1,832.51	11,236.39	3,994.99	3,283.87	1,480.48	1,368.00	1,393.89
1977	11,347.31	8,061.89	6,093.13	3,231.74	2,888.49	2,191.90	13,331.92	3,660.91	3,034.53	1,386.14	1,247.12	1,171.17
1978	14,484.74	10,540.77	7,519.28	4,237.34	3,319.33	2,973.23	15,134.31	4,428.48	3,830.77	1,831.86	1,494.33	1,211.40
1979	19,328.37	13,130.62	10,345.43	4,851.28	4,828.06	4,238.42	18,797.48	4,965.77	5,074.15	2,656.13	1,788.96	1,637.32
	(22.3%)	(15.3%)	(13.3%)	(10.1%)	(9.0%)	(7.3%)	(30.5%)	(13.1%)	(16.1%)	(3.1%)	(4.8%)	(4.9%)
1978: Dec.	1,612.49	1,122.71	698.96	491.84	329.74	291.99	1,473.87	523.77	434.84	199.28	131.38	138.29
1979: Jan.	1,087.64	977.22	636.41	433.84	320.34	360.11	1,236.75	480.73	447.93	186.31	134.86	112.87
Feb.	1,305.71	813.08	601.72	366.56	311.35	192.05	791.10	287.49	237.60	131.30	88.50	76.45
Mar.	1,613.25	1,075.83	749.84	454.28	340.99	321.39	1,211.76	434.43	433.60	193.61	133.58	115.83
Apr.	1,543.83	1,110.87	781.18	476.64	398.16	402.17	1,222.43	443.87	502.39	234.29	131.80	114.79
May	1,616.31	1,237.60	877.20	473.61	332.79	410.82	1,609.33	477.62	511.86	237.00	133.91	147.98
June	1,700.93	1,186.53	871.29	541.46	394.80	389.28	1,646.84	383.79	462.74	209.46	139.13	143.84
July	1,629.32	1,237.33	1,096.46	464.31	480.83	422.76	1,813.89	339.28	486.94	241.43	136.36	147.06
Aug.	1,636.52	1,318.18	947.16	496.59	458.23	438.24	1,970.04	461.53	413.16	177.60	163.37	147.45
Sept.	1,711.29	1,368.37	871.34	525.76	497.41	380.47	1,836.36	362.09	545.42	303.60	171.56	148.29
Oct.	1,831.43	1,393.41	987.69	563.34	498.23	386.17	1,863.43	338.43	537.18	333.51	172.93	186.19
Nov.	1,760.01	1,338.34	998.12	590.93	433.66	454.08	1,722.03	593.71	560.46	333.17	183.96	164.31
Dec.	1,836.23	1,394.80	960.71	663.88	462.33	518.29	1,760.36	743.18	617.48	190.84	166.77	199.33

ATTACHMENT F

THE
PRESIDENT'S EXPORT COUNCIL

SUBCOMMITTEE ON
EXPORT EXPANSION

DECEMBER 5, 1979

REPORT OF THE TASK FORCE TO STUDY THE TAX TREATMENT OF AMERICANS WORKING OVERSEAS

THE PRESIDENT'S EXPORT COUNCIL

SUBCOMMITTEE ON EXPORT EXPANSION

Task Force to Study the Tax Treatment of Americans Working Overseas

I. THE SITUATION

Despite the enactment of the Foreign Earned Income Act of 1978, Americans are still being taxed out of competition in overseas markets. The result is a sharp loss in the United States' share of overseas business volume in vital economic sectors. The current situation contributes to our negative balance of payments, a loss of U.S. jobs to our competitors, and the decline in U.S. presence and prestige abroad.

II. TASK FORCE RECOMMENDATIONS

Americans working overseas are essential to a viable export program. An increase in the number of Americans assigned abroad can increase our exports, reduce the negative balance of payments, enhance our country's image, and raise employment in the U.S.

Recognizing that it is in the best interest of our nation to encourage Americans to work overseas, the Task Force recommends the adoption of tax policies that are comparable to those of major competing industrial nations, none of which now taxes citizens who meet overseas residency tests. We urge the development and enactment of new legislation to put Americans who work in the private sector overseas on the same tax footing as citizens of competing industrial nations. In the interim, the following remedial actions should be taken.

1. Regulations and interpretations in force under the current tax law concerning Americans living in camps in hardship areas (Section 911) should be simplified and made less restrictive, in keeping with the intent of Congress.

2. The current tax law concerning allowances to employees for excess living costs incurred while working abroad (Section 913) should be interpreted in the least restrictive and simplest manner.

3. Work should begin immediately to encourage enactment of a new tax law to put Americans working overseas on the same tax footing as citizens from competing industrial nations.

III. BACKGROUND

Foreign Trade Encouraged

Beginning in the 1920's, after the U.S. emerged from World War I as a major exporting nation, the income earned by Americans at work in foreign countries was virtually exempt or excluded from U.S. taxes, as a matter of public policy and by specific acts of Congress. The purpose was to encourage foreign trade. It was recognized that the export of U.S. goods and services depended, in large measure, on the presence of Americans in overseas markets.

The U.S. tax policy was not unique. All of our trading partners, and certainly all of the world's major producing nations, had long excluded income earned by citizens at work overseas from taxation.

In the early 1950's some revisions were made in the tax treatment of U.S. citizens working overseas. The principal aim was to halt abuses by highly paid movie stars. These revisions altered foreign residency tests and placed a ceiling on the amount of foreign-earned income that could be excluded. The income and allowances of most Americans working overseas was below the $20,000 limit, so they were not affected. They were not meant to be.

Additional technical adjustments were made during the 1960's in foreign residency tests and in the sums that could be excluded. By the mid-1970's, the effects of inflation -- rising living costs and rising salaries and benefits for overseas American workers -- had overtaken the amount of foreign-earned income that could be excluded from U.S. taxes.

Policy Shifts in 1976

Responding to misguided arguments that Americans overseas were being granted preferential tax treatment, Congress in 1976 reduced the exclusion to $15,000 and changed the manner in which it was computed so its maximum practical effect became about $3,000. The philosophy behind these provisions was directly contrary to the principles which had guided the United States' tax treatment of overseas Americans for more than 50 years. Instead of encouraging Americans to work overseas, the 1976 amendments actually discouraged such employment. In fact, even before the 1976 amendments, it was becoming less attractive to work overseas. Inflation was running at between 50 percent and 300 percent higher than domestic inflation, a fact that should have been recognized by increasing the $20,000 exclusion rather than decreasing it.

Further, the Tax Court ruled in 1976 that employer furnished housing was taxable to employees at full local rental value, rather than the value of similar housing in the United States. These rulings were interpreted as a strong indication that employer contributions to offset extraordinary overseas living expenses --

or so-called "keep whole" contributions -- were taxable to overseas employees, whereas such amounts often may have gone unreported up to that time.

These rulings, when combined with the 1976 tax code revisions, produced effects that Congress and the Tax Court did not foresee. For example, in the oil-rich Middle East, the costs to an employer of maintaining an American worker at something approximating the standard of living he or she would have enjoyed at home could exceed the actual salary paid to that worker by three or four times. As a result, some Americans overseas became liable for more taxes than they received in real income.

The 1976 tax policy shifts on foreign-earned income actually amounted to a substantial tariff on our own goods and services by our own government.

Foreign Earned Income Act of 1978

After belatedly postponing the effective date of the tax code revisions, Congress moved in 1978 to remedy the devastating mistakes of 1976 with the Foreign Earned Income Act. Unfortunately, the 1978 Act is inadequate. The House of Representatives had passed a realistic bill, but the law that was eventually enacted represents a compromise with a more restrictive Senate version. Section 911 of the Act provides a $20,000 exclusion for overseas Americans living in qualified camps in remote hardship areas. Section 913 provides deductions for certain allowances for extraordinary overseas living expenses under fairly strict qualifications. Both Sections 911 and 913 are very complex. Moreover, regulations drafted by the Internal Revenue Service under the new law effectively reverse the intent of Congress by compounding the complexities beyond reason.

Even if the Foreign Earned Income Act of 1978 is interpreted in the least restrictive way possible, it is clear that overseas Americans are not currently competitive with citizens of other nations in terms of taxes.

IV. RATIONALE FOR RECOMMENDATIONS

Americans at work overseas direct business to our domestic economy. If we are to increase exports in order to bring our trade accounts into balance, we must encourage more U.S. citizens to accept assignments with American business overseas. Concurrently, we must continue to be sensitive to the geo-political ramifications of having more Americans working abroad. Overseas employees of American business are seen as representatives of our country. Through their participation and visibility in international business affairs, they can function as goodwill ambassadors whose work exemplifies America's ideals and values.

To achieve these benefits will require, among other things, that current tax laws bearing on foreign-earned income be changed. At present, our nation's tax policies discourage the employment of Americans overseas. Many American companies doing business overseas, especially in the manpower-intensive service industries, are sending American employees home in order to keep some vestige of market share. For example:

-- Recruiting firms in France, Germany, Italy and the United Kingdom report they are swamped with requests for qualified citizens of their respective countries to replace Americans who are being forced home by U.S. tax policies.

-- Several leading U.S. contractors in the Middle East have reduced their American staffs by more than half, and adopted hiring policies overseas that specifically exclude Americans on future work.

-- The University of Petroleum and Minerals in Saudi Arabia says Americans now make up less than 30 percent of its teaching staff, compared to more than 80 percent several years ago.

Replacing American employees with citizens of other countries is the only way American companies can remain competitive. This means that as U.S. companies operating overseas "de-Americanize," sales of goods and services move away from this country and toward the competing industrial nations.

-- A report by the Government Accounting Office suggested that the impact of current U.S. tax policies for overseas Americans might be very significant--with a reduction of 5% or more of total exports or a loss in overseas sales of at least $6 to $7 billion, based on available data. And the GAO report cautioned that its projections might well prove conservative.[1]

---

[1] Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas, Report to the Congress, Comptroller General, February 21, 1978, page 10.

-- The Commercial Counselor of the Embassy of Saudi Arabia recently observed:

> "U.S. tax treatment of American companies doing business in foreign countries makes them less competitive vis a vis European and Japanese (and other) companies, which receive better tax treatment from their governments. In the case of Saudi Arabia, it is noticed that American companies, in order to overcome the higher costs resulting from the unfavorable tax treatment, have tended to hire non-American engineers and other skilled personnel. Naturally, these prefer equipment and specifications originating in their countries (European or Japanese, etc.), which represent a loss in American exports to Saudi Arabia. Thus, the end result of U.S. tax treatment of American personnel working abroad has been a net loss of American sales abroad."

That means a loss of jobs in our economy. Estimates vary. Using the low end of the Department of Commerce estimate that for every $1 billion in new economic activity between 40,000 and 70,000 jobs are created, a loss of 5% of our current overseas export volume--or about $7 billion in economic activity--would produce a job loss of 210,000. Using the same Department of Commerce figures, if the U.S. decided on policies to increase exports by at least $30 billion annually as a means of bringing the trade accounts into balance, at least 1.2 million new jobs would result.

If we increase our nation's exports we will increase job opportunities for Americans at home and abroad. In order to achieve such improvement, we must re-assess our tax policies. We also must write new tax laws directed at placing Americans on a competitive footing with other nationals in overseas markets. (See Chart Below)

V. CONCLUSION

The principle underlying the taxation of Americans working in other countries should be to encourage, rather than discourage, employment with U.S. business overseas. The implementation of this principle through changes to the Internal Revenue Code will increase the number of U.S. citizens who are willing to work overseas, resulting in an increase in American exports.

Respectfully Submitted,

Robert Dickey III
John Wood Brooks
D.L. Commons
Maurice Sonnenberg

December 5, 1979

Comparison of Tax Policies for Overseas Employees

Country	Tax on Salary	Tax on Incentive Bonuses	Tax on Benefits (Retirement Health Insurance Etc.)	Tax on Cost of Living Allowances	Tax on Additional Income Earned Out of Home Country	Notes:	Government Subsidies (To Individuals)
United States	Yes[1]	Yes	Yes	Yes[2]	Yes	[1] 20,000 exclusion under Section 911 for those in qualified camps. [2] Certain deductions permitted under complex Section 913 tests.	No
Japan	No	No	No	No	No[1]	[1] Rental, interest, etc. on off-shore investments totally exempt from taxation during non-residence status only.	Yes
Italy	No[1]	No	No	No[2]	Complex formulas to discourage foreign investments	[1] Complex non-residency requirements. [2] Limitation placed on daily expenses for home leave and R&R.	Government owned companies
France	No[1 2]	No	No	No	Complex formulas	[1] Assumes accompanied tour rules for dual residency—unaccompanied—very complex. [2] Recent government policy aimed to encourage more French engineers to accept overseas work.	Government owned companies
Korea	No	No	No	No	No	[1] Most liberal policies with respect to individuals — Korea committed to exports of domestic unemployment.	Yes
Germany	No[1]	No[2]	No	No[3]	Some limitations. Generally liberal.	[1] Complex non-residency requirements aimed at tours of less than 6 months. [2] Complex definitions. [3] Some limitations designed to reduce excesses.	Few
Canada	No[1]	No	No	No	No	[1] Accompanied tour only. If family of head of household remains in Canada all worldwide earnings subject to full taxation.	No
Sweden	No	No	No	No	No	[1] Recently liberalized tax policies in order to encourage acceptance of overseas assignments.	Few
United Kingdom	No	No[1]	No[2]	No	Complex requirements	[1] U.K. recently liberalized tax policies in order to encourage. [2] Some limitations.	Few

Compiled from data provided in Worldwide Projects and Business International S.A. Consultica S.A., a multiclient study, The Expatriate Employee, 1979

ATTACHMENT G

TAX PROBLEMS OF INDEPENDENT AMERICANS ABROAD

Americans living and working overseas have unique tax problems. The United States is the only developed country which imposes taxes on the foreign earnings of its citizens and residents. Since most American based multinational corporations must compensate their American personnel for the increased tax burden resulting from overseas employment, they are hiring more and more non-Americans to fill jobs which were formerly held by Americans in order to remain cost-competitive with their international competitors whose expatriate employees are not taxed by their home country.

The problems of those expatriate Americans working for multinational employers and the resulting problems faced by the American employers of such workers has already been well documented in presentations made to this committee. The principal burden of this presentation will be to show the committee how the taxation of foreign earnings makes the independent American abroad even less competitive since he must charge more for his goods or services in order to realize the same after tax profit as his non-American competitor.

Who are the independent Americans? For purposes of this presentation, they include doctors, lawyers, manufacturers' representatives, insurance salesmen, stock brokers, small shop owners, consultants, journalists and photographers, ministers and missionaries, artists, musicians, school teachers and all others who are not under a tax equalization umbrella, including those who work for non-U.S. employers.

I think the best way to emphasize the problems faced by the independent American overseas is to contrast it with the problems of those who are under a tax equalization umbrella. In order to do this, I am first going to present the problem actually faced by one of my clients who is under a tax equalization program. This particular client is single and was recently posted to Hong Kong to coordinate the financial and investment activities of a relatively small multinational company. His salary base is $45,000 per year and he is to be provided a flat of a size and quality to enable him to conduct necessary business entertaining. His rent is $25,000 per year with an additional expense of $2,500 for utilities and $3,000 per year for domestic help. His total compensation package amounted to $75,500.

This man was incorrectly advised by his employer that his overseas earnings would not be subject to U.S. tax and his only tax liability would be a Hong Kong Tax of 15% of his base salary. Under those circumstances, he expected to have disposable after tax income of $38,250 ($45,000 less $6,750 Hong Kong tax) and tax free accommodations.

Following are an income tax projection and a disposable income projection based on the above facts using 1979 tax rates and exemptions:

INCOME TAX PROJECTION

EARNINGS:	
Salary	$45,000
Housing	25,000
Utilities	2,500
Domestic Help	3,000
TOTAL EARNINGS	$75,500
Sec. 913 Deductions	(19,220)
ADJUSTED GROSS INCOME	$56,280
Personal Exemption	(1,000)
TAXABLE INCOME	$55,280
U.S. Tax Thereon	$20,282

DISPOSABLE INCOME CALCULATION

TOTAL EARNINGS	$75,500
Less: Housing	(25,000)
Utilities	(2,500)
Domestic Help	(3,000)
U.S. Income Tax	(20,282)
Disposable After Tax Income	$24,718

Since his Hong Kong tax will be taken as a credit against his U.S. income tax, his total tax liability will equal the U.S. tax liability shown.

Since the net after tax income he expected was $38,250 and it is actually only $24,718, there is a shortfall of $13,532. As he is in the 50% maximum tax on personal service income bracket, it would seem that all that is necessary to make him whole would be a tax equalization payment of double the shortfall. Not so, however. Since an increase in compensation reduces the allowable amount of his Sec. 913 housing deduction, it is actually necessary for him to receive a $36,000 tax equalization payment, which is 266% of the shortfall! Here are the projections based on the increased compensation resulting from that tax equalization payment:

INCOME TAX PROJECTION

EARNINGS:	
Salary	$45,000
Housing	25,000
Utilities	2,500
Domestic Help	3,000
Tax Equalization	36,000
TOTAL EARNINGS	$109,000
Sec. 913 Deductions	(12,520)
ADJUSTED GROSS INCOME	$ 96,480
Personal Exemption	(1,000)
TAXABLE INCOME	$ 95,480
U.S. Tax Thereon	$ 40,382

DISPOSABLE INCOME CALCULATION

TOTAL EARNINGS	$109,000
Less: Housing	(25,000)
Utilities	(2,500)
Domestic Help	(3,000)
U.S. Income Tax	(40,382)
Disposable After Tax Income	$ 38,118

Independent Americans abroad are not so fortunate as my client in the example above. If my client had been employed by a non-U.S. employer he would have undoubtedly been told that $75,500 was the compensation package and he could take it or leave it. Thus the actions of our own government make the employment of Americans abroad a luxury which few employers--including American based multinationals--can continue to afford. I would like to cite the specific example of one company's experience.

In the June, 1979, issue of THE OVERSEAS TAXSAVER, I wrote the following:

> "This spring, Duty Free Shoppers, Ltd., a Hong Hong based multi-national company, was hiring five new executives in the $50,000 per year bracket. In the past, the company has always recruited Americans. However, the onerous burden the new tax law places on employers who make their employees whole on tax costs caused the company to recruit in Europe. Had the old Sec. 911 exclusion of $20,000/25,000 remained in effect, these jobs would have been filled with Americans and IRS would have collected some taxes, surplus earnings would have been deposited and invested in the U.S., and the executives would have been predisposed to buy American made goods and services. The five Europeans will pay no taxes to their home country or to the U.S. and it is highly unlikely that their savings and investments will flow to the U.S. In addition, they will be predisposed to buy European products. Is that the result that Congress was seeking when it passed the Foreign Earned Income Act of 1978? I doubt it."

Five executives were hired. None were Americans. They do not pay taxes to either their home country or the U.S. They do not put their savings in the U.S. and their buying trips are to London rather than to New York and Los Angeles. The company is now recruiting assistants for some of these executives. No, they are not recruiting in New York. Once again they are recruiting in England. After all, if they hired American assistants they would have to pay them more than they pay the senior executives!

Those individuals who are in business for themselves are really the ones who suffer most under the United States' disastrous tax policies. Not only must they comply with all the requirements of their host government but they must also comply with the requirements of the United States Government. Not only must they pay taxes to their host government, but they must also pay taxes to the United States. Let's return to the example of my client above. Let's assume that he was self-employed and wanted to realize the same after tax income as his next door neighbor in the same business or profession. Are his clients or customers likely to be willing to pay enough for his goods or services to enable him to increase his pre-tax profit by 48%? Not likely.

The independent American abroad does contribute materially to the American economy. American insurance salesmen, real estate salesmen, investment brokers, and manufacturers' representatives all sell American products and are responsible for the inflow of millions of dollars into the United States. Individually, all of us buy American products for our own use. Most Americans concentrate their investments in the United States and maintain the bulk of their savings in the United States. Most of us will ultimately retire in the United States. We live and work with expatriates from other countries who do the same things with respect to their home countries. The big difference is that the governments of other countries tell their citizens to go out and make money and come home to spend it. Our Government tells us to go out and make it and send it home for the Government to spend.

There are important differences between independent Americans abroad and those who are working under a tax equalization umbrella. The independent must pay all his own costs including increased taxes; the protected employee gets compensated for all such costs. The independent must provide his own medical insurance and retirement plans; the protected employee usually gets these as fringe benefits. The independent is not covered by social security; the protected employee is.

Perhaps the most important difference between independent Americans abroad and protected employees is the result of the tax system itself. Any increase in the tax burden abroad is born directly by the independent taxpayer whereas the employing company bears the burden (and gets the deduction) for protected employees. Likewise, any relief in the tax burden will directly benefit the independant taxpayer and will lower the costs of the employing company in the case of protected employees.

The reason I have pointed out these differences between independant Americans abroad and those who are under a tax equalization umbrella is not to ask for different treatment for them but to ask for equal treatment for them. What I would suggest is the complete abolition of taxes on foreign earnings of Americans abroad. Independant taxpayers would benefit in that they would then be directly competitive with their non-American peers. Employers of protected employees would benefit because the resulting lower costs would restore their competitive edge. And, last but far from least, all Americans would benefit because Americans overseas could concentrate on expanding American exports to create more American jobs instead of worrying about paying an ever higher tax burden.

I. H. Fredricks

ATTACHMENT H

INCOME AND TAX COMPARISONS FOR US AND HONG KONG

A brief summary of the pertinent portions of Hong Kong taxes that apply to incomes follows. For full explanation, please refer to the Ordinance.

For expatriate individuals, the main Hong Kong tax is the Salaries Tax under Inland Revenue Ordinance Chapter 112 Part III. The tax is graduated from 5% to 30% in steps of HK$10,000 (US$2,000) with a maximum overall limitation of 15% on total assessable income. Salaries of husband and wife must be aggregated. Expatriates generally are at the maximum 15% level.

In addition, there is an interext tax under Part V of the same Ordinance. The interest tax rate is 15%, but interest received by individuals from banks paid at the current rate of 9-1/4% or less is exempt. This effectively exempts interest from savings accounts from tax.

There is no tax on capital gains. Such items as rent refunds or residence provided by employer, leave travel and stock options can be structured in such a manner as to be largely exempt from tax.

For any business regardless of legal form, there is a Profits Tax under Part IV of this same Ordinance at the current rate of 17%.

In co-ordinating the responses received from the American Community in Hong Kong, it was necessary to try to sort out the common problems as everyone responding seems to have some additional unique situations. Two sets of basic examples have been compiled.

ASSUMPTIONS:

EXAMPLE A-1

Husband and wife file a joint return with no dependents and no itemized decutions. Husband has base salary of US$25,000. Wife does not work.

When comparing the same person in Hong Kong, assume that husband has 15% foreign cost of living allowance. To maintain employee's portion of housing expense to approximately 20% of salary, employer reimburses the rent difference. Using current rent figures for about a 1,800 sq.ft. flat, total rent would be approximately US$14,400 and the reimbursement would be $9,400. The couple takes home leave costing $3,400 which is reimbursed by employer.

EXAMPLE A-2

Same as A-1 except wife earns salary of $11,000.

EXAMPLE A-3

Same as A-1 except wife earns salary of $20,000.

EXAMPLE B-1

Husband and wife file joint return with no dependents. In the US, they own their own home resulting in excess itemized deductions of $5,500. Wife does not work. Total salary, bonus and commissions for husband are $70,580.

For the same couple in Hong Kong, the husband receives only rent reimbursement for about 42% of housing costs. In 1978, a 2,200 sq.ft. flat rents at about US$18,545, but in 1979, rent increases to US$34,800. To keep employee's housing cost constant at 10,820, employer increases reimbursement to 69% or $23,980.

EXAMPLE B-2

Same as B-1 except wife earns a salary of 11,000.

EXAMPLE B-3

Same as B-1 except wife earns a salary of $30,000.

EXAMPLE A-1

			Pre-1976 Rules	Foreign Earned Income Act of 1978		
	1977/78 US	1979 US	1977 HK	1978 HK	1979 HK	
HUSBAND						
Basic Salary	25,000.00	25,000.00	25,000.00	25,000.00	25,000.00	
15% Cost of Living Allowance	---	---	3,750.00	3,750.00	3,750.00	
Taxable, Hong Kong	---	---	28,750.00	28,750.00	28,750.00	
65% Rent Reimbursed	---	---	9,400.00	9,400.00	9,400.00	
Home Leave Travel	---	---	3,400.00	3,400.00	3,400.00	
Husband's Income	25,000.00	25,000.00	41,550.00	41,550.00	41,550.00	
WIFE						
Basic Salary	---	---	---	---	---	
Joint Income	25,000.00	25,000.00	41,550.00	41,550.00	41,550.00	
Sec 911 Exclusion	---	---	(20,000.00)	---	---	
Sec 913 Housing	---	---	---	(9,910.00)	(9,770.00)	
Sec 913 COL	---	---	---	(1,300.00)	(600.00)	
Sec 913 Home Leave	---	---	---	(3,400.00)	(3,400.00)	
Total 911/913 Exclusions	---	---	(20,000.00)	(14,610.00)	(13,770.00)	
Adjusted Gross Incomes	25,000.00	25,000.00	21,550.00	26,940.00	27,780.00	
Personal Deductions						
Taxable Income						
Hong Kong Tax - Husband Portion	---	---	4,313.00	4,313.00	4,313.00	
Hong Kong Tax - Wife Portion	---	---	---	---	---	
Total US Tax (Before Credit)	4,304.00	4,064.00	3,325.00	4,912.00	4,881.00	
Effective Total US Tax Rate on Combined Basic Salary	17%	16%	13%	20%	20%	
Incremental Total Tax Amount Due to Wife's Salary	---	---	---	---	---	
Effective Tax Rate on Wife	---	---	---	---	---	
% Tax Burden Greater for Same Salary than any other National in Hong Kong -						
Husband	---	---	same	114%	113%	
Wife	---	---	---	---	---	

EXAMPLE A-2

			Pre-1976 Rules	Foreign Earned Income Act of 1978		
	1977/78 US	1979 US	1977 HK	1978 HK	1979 HK	
HUSBAND						
Basic Salary	25,000.00	25,000.00	25,000.00	25,000.00	25,000.00	
15% Cost of Living Allowance	---	---	3,750.00	3,750.00	3,750.00	
Taxable, Hong Kong	---	---	28,750.00	28,750.00	28,750.00	
63% Rent Reimbursed	---	---	9,400.00	9,400.00	9,400.00	
Home Leave Travel	---	---	3,400.00	3,400.00	3,400.00	
Husband's Income	25,000.00	25,000.00	41,550.00	41,550.00	41,550.00	
WIFE						
Basic Salary	11,000.00	11,000.00	11,000.00	11,000.00	11,000.00	
Joint Income	36,000.00	36,000.00	52,550.00	52,550.00	52,550.00	
Sec 911 Exclusion	---	---	(31,000.00)	---	---	
Sec 913 Housing	---	---	---	(7,710.00)	(7,570.00)	
Sec 913 COL	---	---	---	(1,300.00)	(600.00)	
Sec 913 Home Leave	---	---	---	(3,400.00)	(3,400.00)	
Total 911/913 Exclusions	---	---	(31,000.00)	(12,410.00)	(11,570.00)	
Adjusted Gross Incomes	36,000.00	36,000.00	21,550.00	40,140.00	40,980.00	
Personal Deductions	---	---	---	1,500.00	(2,000.00)	
Taxable Income	---	---	---	38,640.00	38,980.00	
Hong Kong Tax - Husband Portion	---	---	4,313.00	4,313.00	4,313.00	
Hong Kong Tax - Wife Portion	---	---	1,650.00	1,650.00	1,690.00	
Total US Tax (Before Credit)	8,217.00	7,727.00	9,329.00	10,109.00	9,787.00	
Effective Total US Tax Rate on Combined Basic Salary	23%	21%	9%	28%	27%	
Incremental Total Tax Amount Due to Wife's Salary	3,913.00	3,663.00	1,650.00	5,193.00	4,906.00	
Effective Tax Rate on Wife	36%	33%	15%	47%	45%	
% Tax Burden Greater for Same Salary than any other National in Hong Kong -						
Husband	---	---	same	114%	113%	
Wife	---	---	same	315%	297%	

			Pre-1976 Rules	Foreign Earned Income Act of 1978		
	1977/78 US	1979 US	1977 HK	1978 HK	1979 HK	
HUSBAND						
Basic Salary	25,000.00	25,000.00	25,000.00	25,000.00	25,000.00	
15% Cost of Living Allowance	---	---	3,750.00	3,750.00	3,750.00	
Taxable, Hong Kong	---	---	28,750.00	28,750.00	28,750.00	
65% Rent Reimbursed	---	---	9,400.00	9,400.00	9,400.00	
Home Leave Travel	---	---	3,400.00	3,400.00	3,400.00	
Husband's Income	25,000.00	25,000.00	41,550.00	41,550.00	41,550.00	
WIFE						
Basic Salary	20,000.00	20,000.00	20,000.00	20,000.00	20,000.00	
Joint Income	45,000.00	45,000.00	61,550.00	61,550.00	61,550.00	
Sec 911 Exclusion	---	---	(40,000.00)	---	---	
Sec 913 Housing	---	---	---	(5,910.00)	(5,770.00)	
Sec 913 COL	---	---	---	(1,300.00)	(600.00)	
Sec 913 Home Leave	---	---	---	(3,400.00)	(3,400.00)	
Total 911/913 Exclusions	---	---	(40,000.00)	(10,610.00)	(9,770.00)	
Adjusted Gross Incomes	45,000.00	45,000.00	21,550.00	50,940.00	51,780.00	
Personal Deductions	(1,500.00)	(2,000.00)	---	(1,500.00)	(2,000.00)	
Taxable Income	43,500.00	43,000.00	21,550.00	49,440.00	49,780.00	
Hong Kong Tax - Husband Portion	---	---	4,313.00	4,313.00	4,313.00	
Hong Kong Tax - Wife Portion	---	---	3,000.00	3,000.00	3,000.00	
Total US Tax (Before Credit)	12,284.00	11,916.00	3,325.00	15,000.00	14,670.00	
Effective Total US Tax Rate on Combined Basic Salary	27%	26%	7%	33%	33%	
Incremental Total Tax Amount Due to Wife's Salary	7,980.00	7,452.00	3,000.00	10,088.00	9,789.00	
Effective Tax Rate on Wife	40%	37%	15%	50%	49%	
% Tax Burden Greater for Same Salary than any other National in Hong Kong -						
Husband	---	---	Same	114%	113%	
Wife	---	---	Same	336%	326%	

EXAMPLE B-1

			Pre-1976 Rules	Tax Reform Act of 1976	Foreign Earned Income Act of 1978	
	1977/78 US	1979 US	1977 HK	1978 HK	1978 HK	1979 HK
HUSBAND						
Basic Salary	70,580.00	70,580.00	70.580.00	70,580.00	70,580.00	70,580.00
15% Cost of Living Allowance	---	---	---	---	---	---
Taxable, Hong Kong	---	---	---	---	---	---
42% Rent Reimbursed	---	---	7,725.00	7,725.00	7,725.00	23,980.00
Home Leave Travel	---	---	---	---	---	---
Husband's Income	70,580.00	70,580.00	78,305.00	78,305.00	78,305.00	94,560.00
WIFE						
Basic Salary	---	---	---	---	---	---
Joint Income	70,580.00	70,580.00	78,305.00	78,305.00	78,305.00	94,560.00
Sec 911 Exclusion	---	---	(20,000.00)	(15,000.00)	---	---
Sec 913 Housing	---	---	---	---	(6,853.00)	(22,968.00)
Sec 913 COL	---	---	---	---	(1,300.00)	(600.00)
Sec 913 Home Leave	---	---	---	---	---	---
Total 911/913 Exclusions	---	---	(20,000.00)	(15,000.00)	(8,153.00)	(23,568.00)
Adjusted Gross Incomes	70,580.00	70,580.00	58,305.00	63,305.00	70,152.00	70,992.00
Excess Itemized Deductions	(5,500.00)	(5,500.00)	---	---	---	---
Personal Deductions	(1,500.00)	(2,000.00)	(1,500.00)	(1,500.00)	(1,500.00)	(2,000.00)
Taxable Income	63,580.00	163,080.00	56,805.00	61,805.00	68,652.00	68,992.00
Hong Kong Tax - Husband Portion	---	---	10,587.00	10,587.00	10,587.00	10,587.00
Hong Kong Tax - Wife Portion	---	---	---	---	---	---
Total US Tax (Before Credit)	22,321.00	21,218.00	18,731.00	26,513.00*	25,039.00	24,174.00
Effective Total US Tax Rate on Combined Basic Salary	32%	30%	27%	38%	35%	34%
Incremental Total Tax Amount Due to Wife's Salary	---	---	---	---	---	---
Effective Tax Rate on Wife	---	---	---	---	---	---
% Tax Burden Greater for Same Salary than any other National in Hong Kong -						
Husband	---	---	177%	272%	237%	228%
Wife	---	---	---	---	---	---

* Combined Tax is $28,768 because Foreign Tax Credit is limited to $8,332.

EXAMPLE B-2

			Pre-1976 Rules	Foreign Earned Income Act of 1978		
	1977/78 US	1979 US	1977 HK	1978 HK	1979 HK	
HUSBAND						
Basic Salary, Bonus, Commissions	70,580.00	70,580.00	70,580.00	70,580.00	70,580.00	
15% Cost of Living Allowance	---	---	---	---	---	
Taxable, Hong Kong	---	---	---	---	---	
42% Rent Reimbursed	---	---	7,725.00	7,725.00	23,980.00	
Home Leave Travel	---	---	---	---	---	
Husband's Income	70,580.00	70,580.00	78,305.00	78,305.00	94,560.00	
WIFE						
Basic Salary	11,000.00	11,000.00	11,000.00	11,000.00	11,000.00	
Joint Income	81,580.00	81,580.00	89,305.00	89,305.00	105,560.00	
Sec 911 Exclusion	---	---	(31,000.00)	---	---	
Sec 913 Housing	---	---	---	(4,653.00)	(20,768.00)	
Sec 913 COL	---	---	---	(1,300.00)	(600.00)	
Sec 913 Home Leave	---	---	---	---	---	
Total 911/913 Exclusions	---	---	(31,000.00)	(5,953.00)	(21,368.00)	
Adjusted Gross Incomes	81,580.00	81,580.00	58,305.00	83,352.00	84,193.00)	
Excess Itemized Deductions	(5,500.00)	(5,500.00)	---	---	---	
Personal Deductions	(1,500.00)	(2,000.00)	(1,500.00)	(1,500.00)	(2,000.00)	
Taxable Income	74,580.00	74,580.00	56,805.00	81,852.00	82,193.00	
Hong Kong Tax - Husband Portion	---	---	10,587.00	10,587.00	10,587.00	
Hong Kong Tax - Wife Portion	---	---	1,650.00	1,650.00	1,650.00	
Total US Tax (Before Credit)	27,750.00	26,968.00	18,731.00	31,206.00	30,775.00	
Effective Total US Tax Rate on Combined Basic Salary	34%	33%	27%	38%	38%	
Incremental Total Tax Amount Due to Wife's Salary	5,425.00	5,750.00	1,650.00	6,167.00	6,601.00	
Effective Tax Rate on Wife	49%	52%	15%	56%	60%	
% Tax Burden Greater for Same Salary than any other National in Hong Kong -						
Husband	---	---	177%	237%	228%	
Wife	---	---	Same	374%	400%	

EXAMPLE B-3

			Pre-1976 Rules	Foreign Earned Income Act of 1978		
	1977/78 US	1979 US	1977 HK	1978 HK	1979 HK	
HUSBAND						
Basic Salary	70,580.00	70,580.00	70,580.00	70,580.00	70,580.00	
15% Cost of Living Allowance	---	---	---	---	---	
Taxable, Hong Kong	---	---	---	---	---	
42% Rent Reimbursed	---	---	7,725.00	7,725.00	23,980.00	
Home Leave Travel	---	---	---	---	---	
Husband's Income	70,580.00	70,580.00	78,305.00	78,305.00	94,560.00	
WIFE						
Basic Salary	30,000.00	30,000.00	30,000.00	30,000.00	30,000.00	
Joint Income	100,580.00	100,580.00	108,305.00	108,305.00	124,560.00	
Sec 911 Exclusion	---	---	(40,000.00)	---	---	
Sec 913 Housing	---	---	---	(853.00)	(16,968.00)	
Sec 913 COL	---	---	---	(1,300.00)	(600.00)	
Sec 913 Home Leave	---	---	---	---	---	
Total 911/913 Exclusions	---	---	(40,000.00)	(2,153.00)	(17,568.00)	
Adjusted Gross Incomes	100,580.00	100,580.00	68,305.00	106,152.00	106,992.00	
Excess Itemized Deductions	(5,500.00)	(5,500.00)	---	---	---	
Personal Deductions	(1,500.00)	(2,000.00)	(1,500.00)	(1,500.00)	(2,000.00)	
Taxable Income	93,580.00	93,080.00	66,805.00	104,652.00	104,992.00	
Hong Kong Tax - Husband Portion	---	---	10,587.00	10,587.00	10,587.00	
Hong Kong Tax - Wife Portion	---	---	4,500.00	4,500.00	4,500.00	
Total US Tax (Before Credit)	37,070.00	36,218.00	23,863.00	42,606.00	42,174.00	
Effective Total US Tax Rate on Combined Basic Salary	37%	36%	24%	42%	42%	
Incremental Total Tax Amount Due to Wife's Salary	14,749.00	15,000.00	5,132.00	17,567.00	18,000.00	
Effective Tax Rate on Wife	49%	50%	17%	59%	60%	
% Tax Burden Greater for Same Salary than any other National in Hong Kong -						
Husband	---	---	177%	237%	228%	
Wife	---	---	114%	390%	400%	

ATTACHMENT I

ECONOMIC IMPACT OF
CHANGING TAXATION
OF U.S. WORKERS OVERSEAS

Prepared By:

CHASE ECONOMETRIC ASSOCIATES, INC.

900 17th Street, N.W.
Washington, D.C. 20006

Prepared For:

U.S. and Overseas Tax Fairness Committee

June 1980

PRINCIPAL FINDINGS

The results of our survey and analysis strongly indicate that recent revisions in taxation of U.S. workers abroad have an adverse effect on exports. This causes a reduction in overall tax receipts far greater than the taxes paid by overseas workers. Moreover, the loss of export markets is principally in areas where markets are expanding and where the loss in market share will be felt long into the future.

Among the principal findings are the following:

- **The impact of the tax varies greatly from country to country, raising serious problems of equity.**
- **The after-tax income of U.S. workers overseas is substantially reduced, unless employers provide equalization. For construction workers, the loss averages $3600; for other workers the loss averages about $7600.**
- **A high percentage of U.S. workers abroad -- in some cases as high as 50% or more -- are voluntarily and involuntarily returning to the U.S. because of the tax.**
- **The return of American workers from overseas increases the domestic work force but does not increase the number of domestic jobs. Therefore, domestic unemployment increases.**
- **The cost of maintaining U.S. workers overseas has risen substantially due to the tax. Survey results indicate that these costs add 2 to 10 percent to the cost of U.S. goods and services, depending on the industry involved.**
- **The increased cost of employing U.S. workers overseas and the reduction in the number of U.S. workers overseas reduces the competitiveness of U.S. goods and services abroad and results in a significant drop in exports.**
- **Survey results and other analyses indicate that the overall drop in real U.S. exports amounts to about 5 percent.**
- **The drop in U.S. income due to a 5 percent drop in real exports will raise domestic unemployment by 80,000 and reduce federal receipts from personal and corporate income taxes by more than $6 billion in 1980, many times the value of tax expenditures under Section 911 and 913.**

- Reduced domestic income from lost exports cuts state and local corporate profits taxes by $700 million and state and local personal tax receipts by $100 million. Unemployment compensation payments increase by some $200 million, more than the total additional federal taxes paid by overseas workers.

- Treasury estimates of tax expenditures from Section 911 and 913 overstate the potential gain in revenue since they ignore the drop in corporate profit taxes when employers equalize the pay of overseas workers and they ignore the effect of workers returning to the U.S. to avoid the extra burden of the tax.

- The impact on U.S. export competitiveness is greatest in emerging market countries where such high-value-added U.S. exports as construction and engineering are reduced along with the substantial volume of merchandise exports generated by major projects.

The overwhelming conclusion from these findings is that the negative impacts of the change in taxes on U.S. workers -- on overall tax receipts, on exports, on domestic unemployment, and on other social and economic factors -- are many times greater than the projected gain in personal taxes paid by overseas Americans.

STATEMENT
on
TAXATION OF AMERICANS EMPLOYED ABROAD
before the
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY
of the
SENATE COMMITTEE ON FINANCE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Mark Cohen
June 26, 1980

My name is Mark Cohen. I am Vice President-Taxes and General Tax Counsel of the American Express Company and a member of the U.S. Chamber's Task Force on International Tax Policy, on whose behalf I appear today.

The U.S. Chamber is the world's largest business federation, comprising more than 94,600 businesses, 2,700 state and local chambers of commerce, 1,300 trade and professional associations, and 44 American Chambers of Commerce Abroad (AmChams).

Many of our more than 98,600 members are vitally concerned about the tax treatment of Americans employed abroad. We welcome this opportunity to urge Congressional consideration of the need for more favorable tax treatment in this area.

SUMMARY

U.S. tax treatment of foreign earned income should encourage, rather than discourage, U.S. nationals to work abroad. U.S. citizens and firms abroad are essential agents for promoting exports of U.S. goods and services. Given the increasing economic difficulties facing Americans working overseas, the tax law should not impair the ability of U.S. citizens and businesses to become more competitive with their foreign counterparts.

The U.S. Chamber supports a reexamination of the legislative changes made in 1978 to the taxation of U.S. citizens residing abroad, and commends this Subcommittee for initiating such an effort. While the U.S. Chamber has not yet taken a position with respect to S. 2283, S. 2321, and S. 2418, the specific proposals which are the subject of this hearing, we look forward to working closely with you in fashioning a legislative solution that would promote, rather than discourage, the employment of U.S. citizens abroad. Such a solution, in out judgment, is a critical component in U.S. efforts to generate exports.

THE NEED FOR A COMPREHENSIVE EXPORT POLICY

Evidence exists that the competitive position of United States industry in international trade has been declining. Contributing to this unfortunate trend has been the absence of a clearly stated national emphasis on export expansion, the lack of a carefully designed and consistent set of government policies and programs to encourage exports, and the insufficient awareness on the part of American firms and individuals as to the economic benefits to be derived from exporting.

To promote the expansion of U.S. exports, the United States must develop a long-range, comprehensive effort which includes:

- increased export initiatives from the private sector;
- the removal of a number of government disincentives to exporting;
- the removal of foreign tariff and nontariff barriers; and
- the adoption of consistent government policies and programs to encourage exports.

Tax policy can play a significant role in a comprehensive approach to export expansion. The U.S. Chamber has long advocated tax changes to foster capital formation, in the belief that an improved investment climate in this country will increase productivity, create jobs, reduce inflation, and improve our ability to compete for international markets. At the same time, tax impediments to the achievement of an improved trade balance must be identified and corrected.

One impediment which has been the subject of much criticism is the taxation of Americans employed abroad. The costs to U.S. firms of employing American workers overseas have risen dramatically in recent years, in large part because companies often provide "tax equalization" programs for these employees. In some instances, rising tax costs have forced U.S. employers to reduce the number of their American workers, or to replace them with foreign nationals. This trend has serious consequences for U.S. exports. American workers responsible for purchasing goods or services for their companies are more likely to specify American-made products in fulfilling job requirements abroad than would their foreign counterparts. Increased tax costs hit particularly hard at the service industries, our most rapidly growing area of export, since the product sold by these industries is the technical know-how and managerial expertise of the American worker.

CURRENT TAX TREATMENT OF AMERICANS EMPLOYED ABROAD

Background

An exclusion for income earned abroad has been part of the tax laws since 1926. Initially, U.S. citizens who were bona fide foreign residents were entitled to an unlimited exclusion. It is worthwhile noting that this measure was part of a Congressional effort to encourage foreign trade. In 1953, Congress adopted a $20,000 ceiling for citizens physically present abroad for 17 out of 18 months, which was intended to correct abuses but at the same time not to penalize taxpayers residing abroad for legitimate business reasons.

Prior to the Tax Reform Act of 1976, after several minor changes, section 911 of the Internal Revenue Code provided that United States citizens who were bona fide residents of foreign countries for at least one full calendar year or were physically present in foreign countries for 17 out of 18 consecutive months could exclude from their federal income tax the first $20,000, or in some cases the first $25,000, of compensation received for services performed outside the United States.

The Tax Reform Act of 1976 would have significantly restricted section 911 by reducing the earned income exclusion to $15,000 ($20,000 for employees of U.S. charitable organizations). This would have produced a dramatic increase in the U.S. tax burden of Americans working abroad and forced many businesses either to reduce their foreign operations, or to replace American workers with foreign workers. Congress recognized the extent of this problem and, after postponing for two years the effective date of the 1976 changes, repealed them altogether and enacted the Foreign Earned Income Act of 1978. While this Act increased the U.S. tax burden on many Americans working abroad, the increases were much smaller than those which would have occurred had the 1976 Act gone into effect.

Foreign Earned Income Act of 1978

The Foreign Earned Income Act of 1978 amended section 911 to permit qualifying taxpayers who reside in a "camp" located in a "hardship area" in a foreign country to elect to exclude from gross income up to $20,000 of foreign earned income during the taxable year. The law also added section 913 to the Code, which allows a deduction to qualifying taxpayers for qualified cost-of-living differentials, housing expenses, schooling expenses, home leave travel expenses, and "hardship deductions." These deductions under section 913 are not available to taxpayers who elect the section 911 exclusion.

With the enactment of the Foreign Earned Income Act of 1978, the U.S. Chamber was hopeful that U.S. taxpayers working overseas and their employers would be given some relief from what had become excessively burdensome U.S. taxes. This has not happened, even though as reflected in the Act and its legislative history, Congress clearly intended to put U.S. workers abroad in a position comparable to Americans working in the United States, and not at a disadvantage with other foreign workers.

THE NEED FOR LEGISLATIVE CHANGES

Despite passage of the 1978 legislation, however, significant problems regarding the taxation of foreign earned income remain. As the recent Report of the Task Force on the Tax Treatment of Americans Working Overseas of the President's Export Council found,

> Americans are still being taxed out of competition in overseas markets. The result is a sharp loss in the United States share of overseas business volume in vital economic sectors. The current situation contributes to our negative balance of payments, a loss of U.S. jobs to our competitors, and the decline in U.S. presence and prestige abroad.

The Report concluded that the tax laws should be changed in order "to encourage, rather than discourage, employment with U.S. business overseas." In February, 1978, the U.S. Chamber reached the same conclusion.

Many U.S. companies with American employees working abroad have written to the U.S. Chamber to state their concerns about the extraordinary administrative complexity of the new law as well as the increased tax costs. In fact, recent financial statements released by companies employing Americans abroad indicate that in some instances well in excess of 30 percent of the fees paid to their accountants was spent to comply with the 1978 Foreign Earned Income Act.

Most U.S. companies that employ U.S. citizens abroad have comprehensive tax equalization programs which are designed to place the employees in the same tax position as they would have been in had they been employed in the United States.

For these employees, the increased costs resulting from the 1978 Act are borne by their employers. Americans working overseas not covered by tax equalization programs, including most self-employed individuals, have had to bear all the increased costs themselves.

For some U.S. companies, the 1978 U.S. tax paid for their employees under their tax equalization programs was over 300 percent greater than it was in 1977 under pre-1976 U.S. tax laws. The combined effect of a tax equalization program and the increased administrative complexity has caused many companies to experience additional costs of from $3,000 to $7,000 to maintain one American employee abroad. Since many U.S. businesses have hundreds of Americans working overseas, the total costs to U.S. corporations have been substantial. These increased costs have forced some U.S. companies to cut back on or eliminate sending U.S. nationals overseas and others to replace their American workers with foreign nationals. The resulting loss of U.S. exports and employment costs the Treasury far more than revenue gained under sections 911 and 913.

PROPOSED CHANGES

Three major legislative proposals have been introduced to reform the taxation of Americans working in foreign countries. S. 2321, introduced by Senator Roger W. Jepsen (R-Iowa), would provide a total exclusion from U.S. taxation for foreign earned income, while S. 2418, introduced by Senator Lloyd M. Bentsen (D-Tex.), and S. 2283, introduced by Senator John H. Chafee (R-R.I.), provide a partial exclusion, with a deduction for certain foreign housing costs. Several comments on features of these bills are set forth below.

Residency

The proposals contain different tests to determine if a taxpayer resides in a foreign country and thus would be entitled to the section 911 exclusion. The subjective test contained in the present law, that a taxpayer must be a bona fide resident of a foreign country for an uninterrupted period which includes an entire taxable year, is found in all of the proposals. The objective test contained in current law, that a taxpayer must be present in a foreign country for 17 months in an 18-month period, is included in S. 2283 and S. 2321. S. 2418 would require only that the taxpayer be present in the foreign country for 11 months during a 12-month period to qualify. In addition, the Bentsen bill would provide a pro rata exclusion for taxpayers who failed to pass the other tests because they had been forced to flee the foreign country due to war or civil unrest.

Both an objective and a subjective test in determining if an American taxpayer is residing in a foreign country are necessary. The subjective test of bona fide residence contained in present law should be retained. But the length of time that an individual needs to remain overseas to satisfy the objective test should be shortened from the present 17 out of 18 months to 11 out of 12 months so as to allow greater flexibility to Americans wishing to work abroad and to businesses wishing to use Americans in overseas projects. In addition to these test, there should be a provision allowing a pro rata exclusion when a taxpayer is forced to flee a foreign country for political reasons. Given the current instability in many areas of the world, it would be better to have this kind of provision in the law than to hurriedly pass a special relief bill as was done after the Americans were forced to lear Iran and Afghanistan.

Limitation On Amount Excluded

While S. 2321 has no limitation, the other bills would set a cap on the amount of foreign earned income that could be excluded. The cap provided in S. 2418 is $60,000 per year, while S. 2283 would limit a taxpayer to $50,000 per year but would raise the cap to $65,000 if the taxpayer satisfied the bona fide residency test and had been in a foreign country for 3 consecutive years. Since the United States is one of the very few countries in the world which taxes the earned income of its citizens abroad, Congress should place American citizens on an equal footing with their foreign competitors. In considering the amount of foreign earned income to be excluded, Congress should at the very least insure that the amount provided is large enough to cover the salaries paid to the great majority of Americans working overseas.

Section 119

Section 119 allows an employee to exclude from income the value of meals and lodgings provided by an employer for the employer's convenience if they are provided on the business premises of the employer. S. 2418 would expand the definition of business premises to include camps, and would eliminate the requirement that the area accommodate 10 or more employees. S. 2283 contains no reference to section 119.

The definition of an employer's business premises should be expanded to include camps. An employee residing in a camp does so both as a condition of taking this job and for the employer's convenience. The fact that an employer may not be performing business activities directly at the camp should not be a factor. In addition, the employee should not have to satisfy any residency test to be entitled to the benefits of section 119.

Deductions For Excess Living Costs

Under S. 2283, in addition to a fixed exclusion, a taxpayer also would be entitled to deduct the greater of: (a) the amount by which the housing allowance exceeded 20 percent of the taxpayer's earned income, not including the housing allowance; or (b) the amount by which the taxpayer's housing expenses exceed 20 percent of his earned income. "Housing allowance" is defined as the reasonable expenses paid by the taxpayer for housing. This is the same definition of housing expense used presently in section 913(e)(2)(A). Thus no clarification is provided as to whether furniture rental, servants, or security costs can be included as housing expenses. The Chafee bill, however, omits the provision currently in section 913(e)(2)(B), which disallows housing costs that are lavish and extravagant under the circumstances.

S. 2418 would place the deduction for excess housing costs in a separate section, replacing present section 913. It would allow taxpayers to deduct the amount by which housing costs exceed a base amount. The definition of housing costs is similar to that found currently in section 913, but specifically includes security costs. The bill would continue the present disallowance of housing costs that are lavish or extravagant. The base amount is defined as 16 percent of the salary of a U.S. government employee who is at step 1 of salary grade GS-14.

Allowing a deduction for excess housing costs recognizes that taxpayers working abroad may have to pay more for housing than they would in the United States. If a complete exclusion is not enacted, Congress should consider retaining a deduction for excess housing costs, along with the deductions for cost-of-living differential, school expenses and home leave travel expenses currently in the law.

The definition of housing costs should be broadened and the formula for determining the amount of the deduction made as simple as possible. Since many taxpayers living overseas find it cheaper to rent furniture than bring it from the U.S., that cost should be included. Likewise, the costs of servants and security which are a necessity in many parts of the world should be included. The fact that a deduction does not fully compensate a taxpayer for the costs incurred should prevent abuse.

CONCLUSION

We are encouraged by the growing Congressional recognition of the self-imposed trade barrier presented by the current tax treatment of Americans employed abroad. We believe that serious Congressional examination of this problem must be continued with a view toward providing a more favorable tax environment for these "vital ambassadors" of U.S. exports.

The U.S. Chamber is eager to participate fully in this Congressional effort to develop a legislative solution that addresses our critical need to reverse the U.S. imbalance of trade by expanding exports.

**COUNCIL OF AMERICAN CHAMBERS OF COMMERCE —
EUROPE AND MEDITERRANEAN (EUROMED)**

Avenue des Arts 50, Bte 5
B-1040 Brussels, Belgium
Telephone: 512.12.62

STATEMENT
to the
SUBCOMMITTEE ON
TAXATION & DEBT MANAGEMENT GENERALLY
of the
SENATE FINANCE COMMITTEE

June 26, 1980

The Council of American Chambers of Commerce--Europe and Mediterranean (EuroMed), representing American business interests in the region with over 15,000 constituent entities in 13 countries, is pleased to be able to present comments concerning the issue of taxation of Americans working and residing abroad.

The objective of this statement is to bring attention to the necessity for altering the present approach to taxation of American residents overseas. It is our belief that the present system has a substantially adverse impact on U.S. exports due to the significantly increased tax burden on American business.

At the present time, the tax status of American residents abroad is governed by the Foreign Earned Income Act of 1978. The Council of American Chambers of Commerce in Europe presented its comments with regard to the temporary and proposed regulations under the Foreign Earned Income Act of 1978 at Treasury Department hearings held on August 18, 1979, bringing attention to specific inadequacies therein. It should be mentioned that over one and one half years have passed since the enactment of the 1978 law, and the regulations have yet to be finalized. In the meantime, there continues to be significant confusion as to the interpretation of the law.

It is felt for a number of reasons that the Foreign Earned Income Act of 1978 does not go far enough towards solving the taxation problems of overseas Americans.

Firstly, taxpayers are treated inequitably because taxation systems vary from country to country and in most cases are different from that in the United States. Indirect taxes such as value-added taxes, in many foreign countries, make up a large portion of the total tax burden and are substitutes to a large extent for direct income taxes. While an individual receives a credit against his U.S. tax for the foreign income taxes he pays, he receives no tax relief, credit or deduction, for indirect taxes paid. Therefore, even though the total amount expended for taxation by similarly compensated individuals in two different countries may be the same, their net U.S. tax, after credits, can vary significantly.

Secondly, the phantom income problem has not been adequately dealt with by the Foreign Earned Income Act of 1978. This concerns the problem of fluctuating exchange rates. An individual living in a foreign country should not be penalized solely due to the fluctuation in value of local currency in terms of U.S. dollars. However, Americans residing in Switzerland, for example, have seen their income for U.S. tax purposes, inflated by approximately 160 percent since 1971 for a given unchanged nominal income expressed in Swiss francs, the country in which their normal living expenses are incurred. An earned income of SF 100,000 was equal to

$23,000 in 1971, but at today's exchange rate is worth about $61,000. While the individual's purchasing power in Swiss francs has actually decreased since 1971 due to inflation, his income, for U.S. tax return purposes, has artificially increased by $38,000, which amount is, of course, included in his taxable income. In addition, his other income has been pushed up into a higher tax bracket due to the graduated tax rate system.

Thirdly, the law itself is very complex. Therefore, an average overseas taxpayer who otherwise would have no problems in preparing his own return in the United States is relatively helpless when time comes to prepare his tax return abroad. This is coupled with the relative lack of taxpayer assistance overseas (both within and without the Internal Revenue Service). The taxpayer may have no alternative but to expend substantial sums for professional help.

The basic system of taxing citizens overseas, in many instances, makes it prohibitively expensive for U.S. companies to employ American citizens to work abroad. The majority of U.S. companies operating abroad offer their American employees tax equalization. As a result, such employees are reimbursed for additional tax costs which exceed the normal tax costs which they would have to pay if they were living in the United States. These reimbursements are, of course, themselves taxable in the year of receipt which results in a spiraling effect, each year compounding the problem further. With the resulting high tax costs of employing Americans abroad, American business overseas is placed at a competitive disadvantage. While this situation as such is not new, the inflation, currency fluctuation, and world economic conditions have in recent years exacerbated an already difficult position of American exports.

The United States is, of course, the only major industrialized nation which taxes its citizens on a world-wide basis, and not just on the basis of residency. Our competitors in overseas markets are not faced with this additional cost of reimbursing their employees for the excess taxes incurred relating to an overseas assignment.

As a result of this competitive disadvantage, companies have been replacing their American employees overseas with foreign nationals who are understandably not thinking in terms of U.S. standards and specifications, but rather in their national product norms. This has been confirmed in a recent study prepared by Professor Andre Laurent at Insead in France, as reported in the June issue of International Management Magazine, a McGraw-Hill publication. Professor Laurent researched the question of a manager's nationality playing a role in his business decisions. The study indicates that if a Frenchman (or a German) is appointed to a management position of an American company, he more often than not continues to think in French or German terms.

Approximately 50 percent of total U.S. exports are sold to or through U.S. overseas subsidiaries. In addition, many U.S. firms are losing contracts in foreign countries where the American expertise is imperative and a foreign national would be inadequate.

The reduction in the number of Americans employed overseas has been estimated in the Chase Econometrics Study released June 16, 1980, to be about 10 percent. This resulted in a 5 percent drop in U.S. exports equalling approximately $16 billion. Roughly 40,000 jobs in the United States are dependent on every billion dollars in U.S. exports. Americans forced to return to the United States from abroad are, of course, competing for U.S. jobs.

From a preliminary review of a survey which we conducted through the American Chamber of Commerce in Belgium, it appears that one-third of the American companies in Belgium have decreased their American staff since 1976. Of the companies represented by that one third, 43 percent specifically cited the continued taxation of U.S. citizens as the sole or major reason for the withdrawal of personnel. Sixty-one percent cited the combined effect of taxation and compensation costs. The survey results are based on a 38 percent response to the 1160 questionnaires sent to U.S. companies in Belgium (447 responses).

In addition to the revenue aspects there should also be considered the matter of American presence abroad and prestige in the international market place. The average American residing abroad is looked upon as an unofficial ambassador. He comes into contact with foreign nationals on a daily basis and represents the United States abroad. We should not deprive our country of one of its best means of communication in the international arena.

In conclusion, we would like to emphasize the importance for thorough consideration of the matter and the need to find an equitable alternative to the present provisions of the tax law. The ideal solution is one which should be fair to the United States, to its citizens residing abroad, and it should be practicable. In the best interests of the U.S. economy, such a solution should be one which puts the United States on an equal footing with its competitors in the international market place.

Your efforts in this regard are sincerely appreciated and we will be pleased to provide our support and assistance as deemed appropriate.

Respectfully submitted,

Council of American Chambers of Commerce--
Europe and Mediterranean

Milan F. Ondrus
Chairman

Steven Kraft
Tax Committee Chairman

APCAC

THE ASIA-PACIFIC COUNCIL OF AMERICAN CHAMBERS OF COMMERCE

STATEMENT OF
GEORGE LIESENBERG
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGMENT
OF THE
SENATE COMMITTEE ON FINANCE
JUNE 26, 1980

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

My name is George Liesenberg and I am a partner with the accounting firm of Arthur Young & Company based in Singapore. I have traveled 12,000 miles to speak on behalf of the Asian Pacific Council of American Chambers of Commerce (APCAC), which represents U.S. business in 12 Asian-Pacific countries.

APCAC strongly believes that the taxation of the earned income of Americans working overseas adversely affects the ability of U.S. companies and small businessmen to compete in the international market place. This tax policy is one of the most critical problems American business faces in our area. This point was thoroughly documented in our testimony previously presented to the Joint Economic Committee during their East Asia study trip in January, 1980, and was highlighted in the President's Export Council report issued on December 5, 1979, titled Task Force to Study the Tax Treatment of Americans Working Overseas.

The United States is the only major country in the world which taxes its citizens on income earned while working overseas. This makes it more expensive for American business to employ Americans abroad than third country expatriates or local citizens.

This has led to a relative reduction in Americans abroad. In some cases, there has been an asolute decrease and in other cases, while there has been an increase in the absolute number, it has been at a rate lower than that of nationals from other countries. An example of this trend is a company operating in Singapore with approximately 100 expatriates. The percentage of third country nationals in this expatriate population has increased since 1975 from 19% to 41%. This is typical of many companies operating in the Asia-Pacific region.

The consequent reduction in Americans representing American companies has had a negative impact on U.S. exports. Not only are we losing business because of the high cost of American employees, their replacement by other nationals has resulted in the purchasing of supplies and equipment from the home countries of the non-American managers. As documentation for this adverse impact, I refer you to the Chase Econometric Study.

Small businessmen and employees in service industries who are not reimbursed by parent companies are faced with a worse problem than their American friends in multi-national companies. The employee of the American company generally does not feel any additional personal tax burden because he is reimbursed for his additional costs and it is his company that is the loser. The small businessman, on the other hand, suffers both in his business in which he is carrying a greater burden than his foreign counterpart, but personally as well since he can not pass on the additional costs to his clients or customers.

During the period 1964-1977, the U.S. tax liability of Americans working overseas increased substantially. While this was due in part to the effect of inflation on the $20,000/$25,000 earned income exclusion, the Foreign Earned Income Act of 1978 dramatically increased this U.S. tax cost in most countries of the Asian region. Attached is a summary of the results of a survey recently conducted by APCAC (Appendix A). This survey compares the 1978 U.S. tax liability (before foreign tax credits) of a number of individuals in each country in the region with what they would have paid in the U.S. on their basic salary (excluding the allowances necessary to offset the higher costs of working abroad) and with what their 1978 tax would have been under the old $20,000/$25,000 rules. The percentage increase in U.S. taxes incurred by Americans working in Taiwan was 77%, Singapore--42%, Malaysia--39%, and Hong Kong--24%. The only country showing a decrease in tax under the Foreign Earned Income Act is Japan. Even after considering the foreign tax credit, the current law resulted in a substantial increase in tax in most of the countries.

A major problem for the American working overseas is the complexity of his U.S. tax return. For example, a normal U.S. tax return for a business executive is 7 separate pages of schedules. While working overseas, his tax return will typically include 25 separate pages or schedules.

One reason for this complexity as well as increasing the tax burden, is the very restrictive approach taken by the Internal Revenue Service under their proposed regulations implementing the Foreign Earned Income Act of 1978. The following are some examples to illustrate this point.

1. Section 913 Deductions and Foreign Tax Credit Limitation

deductions to foreign source income for purposes of the utilization of foreign tax credits. This is in spite of the fact that the income to which most of these deductions relate must be allocated between both U.S. and foreign sources based on the location of one's work. This position by the Service has the effect of reducing the benefit of the foreign credits.

2. Cost of Living Differential

The cost of living tables issued for both 1978 and 1979 do not reflect the differences in the cost of living between Boston (which we understand was the reference point) and the overseas locations in the Asian-Pacific region. Table I is a comparison of the IRS cost of living differences with those computed by the Organization Resources Counselors, Inc., (ORC) at the GS-14, Step 1 level with three dependents.

For example, these tables show a cost of living differential of $4,500 in the case of Indonesia, while the IRS provides no cost of living differential. In the case of Hong Kong, the cost of living differential is $5,900 while the IRS deduction is $800. In the case of Malaysia, the ORC indicates the cost of living differential of $3,996, while the IRS deduction is only $1,500. In the case of Singapore, ORC indicates the difference of $4,692 while the IRS is only $2,300. While a small portion of the variance reflects the differences in the cost of living between Boston and Washington, it demonstrates that the IRS tables are unreasonably low.

3. Housing Expenses

Housing regulations prevent the deduction for the cost of furniture. Due to the vast distance, cost, and climate, it does not make economic sense to move household furniture to Asia, although moving expenses would be deductible. Yet under the Regulations, the leasing of furniture is not a deductible housing expense.

TABLE I

COST OF LIVING ALLOWANCE DIFFERENTIALS

COUNTRIES	ORC	IRS
Hong Kong	5,964	800
Indonesia	4,500	None
Japan	14,388	11,200
Korea	4,692	4,500
Malaysia	3,996	1,500
Philippines	528	None
Singapore	4,692	2,300
Taiwan	5,496	800
Thailand	828	None

4. **Education Expenses**

The Regulations indicate that only a portion of the school expense attributable to the number of school days in the tax year is deductible in the year of payment. This limitation is too restrictive and contrary to the concept of the cash-basis reporting taxpayer. In many cases, an American working overseas is provided with educational support for his children by his employer and it is considered income in the year of payment. We believe that the matching of the expense deduction with income recognition should be treated similarly to the matching of moving expense and moving expense reimbursements.

In Summary:

With the current trade imbalance of the U.S., APCAC believes that it is imperative that the U.S. tax laws be restructured to place the Americans working overseas in an equal position with his competitors and to encourage U.S. citizens to live and work overseas to promote the sale of U.S. goods and services. We encourage members of the committee to review the extensive testimony we presented to the Joint Economic Committee during their Asian visit. American business in Asia sincerely appreciates the time, effort and interest of the Joint Economic Committee in our problems.

Accordingly, APCAC strongly recommends that the U.S. law on taxation of Americans overseas be immediately amended to our the U.S. businessman abroad in the same tax position as his competition.

APPENDIX A

APCAC - U.S. TAX STUDY

****

	TAX "AS IF" EMPLOYED IN U.S.	TAX (BEFORE FOREIGN TAX CREDIT) ON PRE-1976 RULES	ACTUAL 1978 TAX (BEFORE FOREIGN TAX CREDIT)	TAX (AFTER FOREIGN TAX CREDIT) ON PRE-1976 RULES	ACTUAL 1978 TAX (AFTER FOREIGN TAX CREDIT)	FOREIGN TAX PAID OR ACCRUED	TOTAL TAX
Hong Kong	15,617	22,683	26,850	11,467	14,167	10,317	24,484
Indonesia	8,533	21,296	24,318	3,106	3,819	18,264	22,083
Japan	10,350	40,526	29,280	13,615	5,042	27,410	32,452
Malaysia	6,187	17,526	21,718	3,257	4,512	23,230	27,742
Philippines	5,652	13,116	16,423	6,431	7,554	5,035	12,589
Singapore	6,620	12,270	14,881	2,423	3,443	13,538	16,981
Taiwan	8,687	10,215	13,934	3,966	7,021	8,134	15,155

Senator CHAFEE. Now, the next panel is from those in the accounting profession. We are now moving to Americans who are not abroad, and so the 5-minute rule will be more rigorously imposed. So, gentlemen, Mr. Linch, Mr. Hart, Mr. Morrione, you are going to address, I take it, handling the tax returns? Who is in charge? Go ahead, Mr. Linch.

STATEMENT OF L. W. LINCH, DELOITTE, HASKINS, & SELLS

Mr. LINCH. Thank you, Senator.

I am L. W. Linch, a partner in the international public accounting firm of Deloitte, Haskins, & Sells. Our clients are large and small multinational companies employing thousands of U.S. citizens overseas. We advise clients of the formation, design, and implementation of——

Senator CHAFEE. Now, everybody is aware of this 5 minutes. The yellow light will go on when they have got 1 minute. The red light and the bell. Go ahead.

Mr. LINCH. We advise clients in the formation, design, and implementation of tax protection and tax equalization plans. We assist them in calculating employee tax reimbursements under these plans, and we prepare income tax returns for their employees overseas.

We recognize the need for reform in the tax rules affecting Americans working overseas. Our present tax system results in very high taxes for expatriates, and this results in high employment costs for their employers because the employers generally bear the burden of this tax cost.

It seems clear that the high taxation of expatriates has a detrimental effect on our competitive position abroad, both in terms of these high costs and in terms of keeping Americans from accepting positions overseas.

The three legislative proposals are responsive to an urgent need for new tax rules, rules that would place U.S. individuals abroad on a comparable taxation footing not just with other Americans, but with the citizens of our competing industrial nations.

These rules would also promote overseas assignments. This would undoubtedly improve the overseas competitive position of U.S. businesses. The inordinately high tax burden on Americans overseas ought to be reduced. There have been two rather full discussions already today of the merits of a complete, full, unlimited exclusion of income. Ideally, this would be the way to meet the problem of overseas competition, because this would put the United States on an equal footing with the overseas nations.

It may be necessary, as has been pointed out, to put a maximum amount in order to prevent abuses and in order to obtain the support that would be necessary for the passage of some reform in this area. Be that as it may, if the full exclusion is not decided upon, then at a minimum the amounts needed by Americans overseas for additional living costs just to maintain a comparable standard of living should not be taxed.

Senator CHAFEE. Well, my bill does that. My bill would exclude that, the additional amount.

Mr. LINCH. Yes. Specifically, your bill addresses housing. There are some other amounts that would also be variable, I think, from place to place, and perhaps they, too, should be taken into account as well as housing outside of the flat exclusion.

Senator CHAFEE. Well, don't you get everything more complicated then?

Mr. LINCH. You do. It is more complicated. It may be necessary, for example, on home leave cost, that can be a fairly substantial item, to bring a family back from Australia, let's say, as compared to bringing them back from Canada, so the differential in the costs may be rather substantial, and the amounts paid by the employer for the purpose of compensating the employee can be rather significant, and perhaps that is an item that should be handled separately from the flat exclusion.

Senator CHAFEE. Well, I was trying to make this as simple as possible. That is the only difficulty. Go ahead.

Mr. LINCH. The flat exclusion certainly is the more straightforward approach, and is the easiest to handle administratively. In addition to the special exclusion of particular living costs, there ought to be a flat exclusion. This flat exclusion, I think, should also be set at a point where it could provide an incentive for Americans to move overseas to accept assignments there.

Senator CHAFEE. What do you mean by flat exclusion? Do you mean a certain amount that is not taxed——

Mr. LINCH. The $50,000 to $65,000 amount such as your bill would include.

Senator CHAFEE. Yes.

Mr. LINCH. One point that I particularly want to make, I want to strongly urge the subcommittee to be sensitive to the effects on the expatriates and their employees of the timing of the passage of legislation in this regard. Twice in recent years, both in 1977 and in 1978, taxpayers were faced with approaching filing deadlines at the time that the rules affecting their tax returns were in the process of being formulated. They got extended deadlines only at the last minute, and this did not alleviate the administrative burden, and I want to emphasize that this resulted in extremely high costs for tax return preparation during those years.

Senator CHAFEE. Thank you. Gentlemen? Go ahead.

STATEMENT OF PETER J. HART, NATIONAL DIRECTOR OF TAX POLICY, PRICE WATERHOUSE & CO.

Mr. HART. Senator, it is a pleasure to be here today. My name is Peter J. Hart. Prior to assuming my present responsibilities as national director of tax policy for Price Waterhouse here in Washington, I spent 2 years in Europe, where I was responsible for our firm's U.S. tax services in Europe, in continental Europe, the United Kingdom, and parts of the Middle East, with special emphasis on the tax situations affecting American individuals resident overseas.

I am appearing before this committee as a representative of Price Waterhouse, a group of international accounting firms having offices in 90 countries. Our clients include many multinational corporations employing U.S. citizens all over the world.

We are presently in the process of finishing preparation of over 8,000 U.S. individual expatriate returns covering the 1979 filing year.

In addition to our U.S.-based staff, we employ over 60 U.S. tax professionals stationed overseas, most of whom are Americans, in an effort to provide services to these individual expatriate clients. Our statement is being submitted on behalf of our firm and not on behalf of any company, organization, or individual.

We favor repeal of section 913 and reinstatement of the earned income exclusion. We believe the legislation proposed by Senator Jepsen which as many have stated today would allow complete earned income exclusion should receive serious consideration. Full exclusion of income earned outside the United States is clearly the simplest and most efficient method of dealing with taxation of Americans overseas. This method would be consistent with the concept of imposing tax on the basis of residence, at least with regard to earned income. This is consistent, as we have heard before, with the policies of most major countries.

Thereby, we would be placing the U.S. employees in overseas locations on a closer income tax parity with our competitors. Your proposal and that of Senator Bentsen, while limiting the exclusion, would provide positive steps in our opinion toward remedying the existing problems created by section 913. In the event that a complete exclusion for earned income is not acceptable for many of the reasons mentioned here today, we believe that your two bills should be given serious consideration.

On that point, we would have one further suggestion. That is that if the approach suggested by Senator Jepsen is unacceptable, and it is found for any number of reasons it is important to include some sort of a cap on the exclusion for earned income, we think that consideration should be given to indexing that cap in connection with passing that legislation from the start.

Senator CHAFEE. I am opposed to indexing. Let's not get into that any more. We will note your objection.

Mr. HART. I understand both sides of that.

Senator CHAFEE. Based on our experience, the special deductions for these living expenses provided by section 913 have fallen short of their intended mark of providing tax equity. In addition, the extensive compliance burdens, resulting in administrative costs, have caused many corporate employers to, as we have heard before, bring employees back to the United States.

In our opinion, 913 is unduly complex and should be repealed.

We have cited in our formal statement for the record a number of situations involving section 913 where we think the deductions fall short of their mark. Clearly the deduction that falls shortest of that mark, is the housing deduction. We think that if section 913 is retained, or if the earned income exclusion is reinstated, that consideration should be given, as in your bill, to having some sort of housing provision, and we think that housing provision, whether it is a deduction or a further exclusion, should be as simple and straightforward as possible.

The current 913 deduction is complicated, involved, and in our experience most U.S. taxpayers overseas get no benefit from it. Thank you.

Senator CHAFEE. I hope Mr. Lubick's representative listens to that, because he indicated that he gave some mild defense of the

913 and said that my provision was no different. Do you think that taking the 20 percent is a manageable one?

Mr. HART. With all due deference, in reading both your proposal and Senator Bentsen's, it seems to me, at least from an administrative standpoint, that Senator Bentsen's approach is more straightforward, and is more simple to administer. It might be a bit more liberal from the taxpayer's standpoint. I have not analyzed the two.

Senator CHAFEE. How does his work?

Mr. HART. His bill [Senator Benster's] provides for a deduction to the extent housing expense incurred exceeds 16⅔ percent of a GS-14 salary.

Senator CHAFEE. All right. Without revealing any confidential information, what percentage of the people would we save from American taxes if we went with the $50,000? In other words, we have a political problem here. Going to the floor, it seems to me, with an unlimited exemption presents problems, and that is where we get into movie actresses abroad and all that. So the question is, What is a decent figure?

Now, I think the testimony has been helpful from Mr. Linch. There are other things, such as the travel home. What do you think is a figure that would take care of most of the situations?

Mr. HART. A reasonable exclusion, that is?

Senator CHAFEE. Yes.

Mr. HART. First, I hesitate to answer in an equivocal sense, because I have not recently looked at many expatriate returns to get a feel for the size of the income, if you will, on the average. We could develop something. We have not tended to do that. But if an exclusion is coupled with some sort of relief in the housing area, such as either you or Senator Bentsen——

Senator CHAFEE. All right. Let's say we took Senator Bentsen's formula on the housing. Let's say we took some kind of a travel home, but this gets into all kinds of problems.

Mr. HART. I think we should do whatever we can do to avoid complications here.

Senator CHAFEE. Maybe just exempt the travel home.

Mr. HART. That is a positive step. This is one of the reasons that we concluded that total exemption in the best of all worlds would be desirable, but we probably can't as a practical matter do that.

Senator CHAFEE. What abuses do you see in a total exemption?

Mr. HART. Apparently significant abuses existed prior to 1962. The publicized cases of the movie stars who became permanent residents in places such as Switzerland, and who were free to come and go in the United States, if you will, and still not pay substantial amounts of income tax.

Senator CHAFEE. But we would get them, wouldn't we, on the 1 month?

Mr. HART. Well, there are two tests, you see. There are two tests that allow expatriates to take advantage of whatever benefits there are in the law regarding earned income. One is the physical presence test, and that test is that you must remain outside of the United States for 17 out of 18 months. The other test is that you be a resident of a foreign country for a period of time which includes one full calendar year. It is an either/or situation, you see, so that people could rely on the residency as opposed to the physical presence.

Senator **Chafee**. Mr. Morrione.

Mr. **Morrione**. Thank you, Mr. Chairman.

Senator **Chafee**. I may have to interrupt you. There is a vote on, and I will come back immediately. But let's see how we get along here. Go ahead.

STATEMENT OF MELCHIOR S. MORRIONE, HEAD OF EXPATRIATE TAX PRACTICE, ARTHUR ANDERSEN & CO.

Mr. **Morrione**. My name is Melchior Morrione. I am a tax partner in the New York Office of Arthur Andersen & Co., and I am responsible for coordinating our firm's expatriate tax practice.

We are pleased that Congress is refocusing its attention on the taxation of Americans working abroad because it is an important area of tax policy, which has a direct influence on the effectiveness of American business abroad. We believe the major tax policy issue underlying this area of taxation is the declining competitive position of U.S. companies in world markets.

During the past decade, the economic balance among industrial nations has decidedly shifted. The competitive position of the U.S. multinational has been significantly weakened.

Senator **Chafee**. Mr. Morrione, I must apologize. Why don't you hold on here, and I will go and vote, and I will be back in 5 minutes.

Why don't we take a 5-minute recess.

[Recess.]

Senator **Chafee**. Please go ahead.

Mr. **Morrione**. As I said earlier, we believe that the major tax policy issue underlying this area of taxation is the declining competitive position of U.S. companies in world markets.

During the past decade, the economic balance among industrial nations has shifted. The competitive position of the U.S. multinational has been significantly weakened, and multinationals based in other countries have quickly moved in to exploit the opportunities available. Analysis of data included in our written statement indicates that American companies have lost the once dominant position they occupied.

The cost of products and services has assumed increased importance in international trade. Non-U.S. multinationals have, through major technological advances and product design efforts, concentrated their efforts on the development of export markets. Since U.S. companies no longer dominate the international marketplace, their competitive position in relation to foreign companies is now based primarily on the cost or their products and services.

Changes in the rules for taxing U.S. expatriates made in 1976 and 1978 aggravated the problem because they increased the cost of maintaining Americans overseas. This higher cost, which is often significant, must be recovered in sales prices, and ultimately puts the U.S. company at a price disadvantage in international competition.

The Foreign Earned Income Act of 1978 focused on tax neutrality, or a perceived tax equity. The objective seems to have been to put U.S. expatriates in a position roughly comparable to that of citizens at home.

The changes did not achieve the objective. They did, however, unduly complicate the law, impose burdensome record keeping and substantiation requirements on both expatriates and their employers, substantially increase the cost to employers of attracting and retaining U.S. citizens abroad, and cause U.S. companies to critically reexamine the cost effectiveness of replacing U.S. expatriates with local and third country nationals.

The basic U.S. tax policy in this area should be: To eliminate disincentives that discourage Americans from accepting overseas assignments, and increase costs for their employers, and to establish a system that will encourage the development of a stronger U.S. presence abroad so as to expand our export markets, and reduce our balance of payments deficits.

In lieu of the complex rules adopted in 1978, we recommend the adoption of a simple system that would provide complete exclusion from U.S. taxation for the earnings of Americans working abroad.

If Congress decides as a matter of policy that there is a potential for abuse, then specific criteria should be adopted which would deny the exclusion for certain types of individuals, or certain classes of taxpayers. Concern over potential abuse should not override the basic tax policy goal of placing Americans working abroad, and their employers, in a comparable tax position with their foreign competitors.

As an alternative, we support the restoration of a flat exclusion approach in the $60,000 to $70,000 range, which at today's price levels would cover the earned income of many U.S. expatriates. The restoration of such an exclusion approach, when compared to the complications under the 1978 changes, would eliminate a substantial part of the tax disincentive to accepting employment abroad, and would be a meaningful step to simplifying the tax system for employers and employees alike.

We appreciate the chance to submit our views on this important area of tax policy, and urge favorable action by the Congress on these proposals so as to make American business more competitive in world markets.

Senator **Chafee**. One phrase you use there is "would eliminate the financial disincentive in accepting employment abroad." Is there a financial disincentive for an American to accept employment abroad—for him personally?

Mr. **Morrione**. Generally, yes, although tax equalization for the most part ordinarily takes care of the extra tax cost incident to the tax on allowances most of the companies do not reimburse employees for the incremental tax that occurs on private income, although that has become popular in recent years. So that if an employee has a substantial amount of private income, or whatever amount of private income, it is taxed at higher rates because it goes on top of everything else.

Senator **Chafee**. If the employee is reimbursed for expenses, it is not taxed, is it, under 913?

Mr. **Morrione**. All the expenses are taxed as income, and he gets a deduction.

Senator **Chafee**. So he gets a deduction.

Mr. MORRIONE. It is that spread (the difference between the individual income and allowable deduction) that is the problem.

Senator CHAFEE. Are you saying that he comes out behind?

Mr. MORRIONE. In theory he should not, Senator. In theory, tax equalization is such that it should put him in a position where he is exactly equivalent financially to where he was had he stayed home.

If that occurs then all you have is the higher cost to the employer because he pays all the allowances and reimbursements, which he then factors into his price. But if a company does not reimburse on the incremental tax on private income, for example, then the employee is at a disadvantage.

Senator CHAFEE. What I am trying to get at here is that it is pretty hard to discern the effect on the individual American. It is the effect on the American company, that is hiring, that is detrimental to our position.

Mr. MORRIONE. That is exactly right.

Senator CHAFEE. Except, if you are an American. We have had so many people come in here who are unassociated with companies. A typical case is the charitable worker who is working overseas, not in a camp. He incurs the increased cost of living and yet works on the same pay he would get back here. The charity cannot afford to give him the extra money. I guess that this is the case of the worker that was cited earlier in the prior round.

Mr. MORRIONE. Yes.

Senator CHAFEE. Is it your opinion, gentlemen, that it is impossible, can we say, for an average, intelligent American overseas to prepare his own income tax return?

Mr. HART. I think that impossible is a pretty strong word. I heard someone say today at lunch that nothing is impossible, but it was impossible to prove it. However, I think that it is safe to say, and I think that it is probably true, however difficult preparation of an individual return is here in the United States the task is much more difficult if he is resident overseas, and qualifies for some of these deductions that are currently available under the 913.

Senator CHAFEE. How many pages would you say would be required? We had some report that it took 24 pages.

Mr. HART. You have a 7- to 24-page comparison. I thought of weighing my 1976 return when I was safely ensconced in Boston and comparing it to my 1977 return when I was in Paris—I did not weigh it, but I will bet that it went from about 4 ounces to close to a pound.

One statistic that I think that in a more serious vein might be interesting to get—I tried to get it and it was not available at least within the time constraints in preparing to come here—is with regard to domestic returns. It would give an indication as to the number of U.S. individual tax returns that are prepared by professional preparers, because as you know there is the required signature. There is a percentage, which I recall is slightly over 50 percent.

Senator CHAFEE. Over 50 percent.

Mr. HART. Slightly over 50 percent.

I suspect that if somehow either your staff or we could get a similar comparison with regard to expatriate returns, you would see that the percentage is significantly higher. If we could get that statistic from the Philadelphia center, it might be very interesting.

There is one other sort of an indicator that I found interesting. We did not make a formal survey, so it is not referred to in our written statement, but that is that many of our offices use a computer service to prepare domestic returns as well as expatriate returns. We talked to one office that used this approach. The particular vendor in that case was charging our clients that remained back here in the United States an average of $100 a return for the form 1040 mechanical processing.

The average expatriate's return prepared by that same office was $140, or a 40-percent increase for the additional mechanics, if you will, cards that are required. It is an indication of the increase in complexity, computation, cumulation, and all sorts of things which tie in and result from the 913.

Senator CHAFEE. Do you, gentlemen, have similar experiences?

Mr. MORRIONE. Yes. In fact, I would like to address your attention to one other burden the expatriate seems to have now under 913 that the typical taxpayer does not have. Put the form aside for the moment, as complicated as it is. He has burdensome requirements to substantiate things like value, or whether cost incurred are the lowest available. I refer specifically, for example, to the schooling deduction.

The expatriate, or someone, must determine—if there is more than one adequate school within a reasonable commuting distance—which is the lowest cost. He is supposed to only be sending his children to the lowest cost one, and that is the only one for which a deduction is permitted.

Qualitative judgment needs to be made. Who makes the judgment? Then, what happens upon examination? The 1-hour commuting distance to that particular school by car or water transportation are difficulties that introduce burdensome requirements that exist nowhere else.

The requirement to go on an accrual basis for some of these deductions, when taxpayers are usually on a cash basis, require the expatriate to pro rate some of his deductions in order to get them. That is not the way it is normally done in the case of individuals.

The burdens are strong, and I believe they are going to get worse as these returns are examined and taxpayers are challenged by the Internal Revenue Service on how they arrived at these qualitative judgments.

Mr. HART. Our foreign offices have indicated that the IRS has increased its staff, at least in Paris, and has increased the audit activity in the expatriate return. Although they do not state that this is as a direct result of the increased complications introduced by 913, or whether it is an honest attempt to understand how 913 is working. They have no way of knowing that. But the audit activity is moving up.

Senator CHAFEE. The last question: What figure would you come up with? You came up with $60,000 to $75,000. Do you think there is anything to having a figure for a certain number of years and then increasing it? With anything beyond 2 years, the amount goes up. Would that encourage them to stay over?

Mr. **MORRIONE**. I really don't know.

Mr. **LINCH**. I can see the value as an incentive, but that would be the principal value of it.

Senator **CHAFEE**. Thank you very much, gentlemen. We appreciate your coming.

[The prepared statement of the preceding panel follows:]

DELOITTE HASKINS & SELLS

Text of Oral Comments by L.W. Pete Linch at the Finance Subcommittee on Taxation and Debt Management Hearings on the Taxation of Foreign Earned Income, June 26, 1980

INTRODUCTION

Thank you very much, Mr. Chairman and members of the Subcommittee. My name is L.W. "Pete" Linch and I am a partner in the international public accounting firm of Deloitte Haskins & Sells. My firm has considerable interest in legislative proposals to revise the taxation rules governing income earned by U.S. citizens and residents working and living abroad. Our clients include large and small multinational corporations employing thousands of U.S. taxpayers in many foreign locations. We advise these corporate clients in the formation, design, and implementation of their tax protection and tax equalization plans and assist them in the computation of employee tax reimbursements. In many of our more than 300 offices in countries throughout the world, we prepare individual U.S. income tax returns for Americans living there who would be affected by these legislative changes.

As an International Tax Partner in our Executive Office in New York, I have responsibilities in all aspects of these services to our clients. Accordingly, my comments to the Subcommittee today are submitted in my capacity as a professional tax advisor practicing in the area of expatriate taxation.

NEED FOR REFORM

We fully support legislative efforts directed toward reform of the tax rules affecting Americans working abroad. Perhaps at no time in our country's modern history has the need been more critical for boosting our export sales and increasing our competitive position for contract work overseas. We are convinced that reduction in the tax burden of U.S. taxpayers abroad can significantly contribute toward those goals and that appropriate legislation should be enacted.

With virtual unanimity, a number of government and private research studies done in the past few years - even as recently as this month - have found persuasive evidence that our comparatively severe taxation of U.S. citizens and residents abroad inhibits our country's export trade effectiveness. Our increasing inability to compete on overseas projects has resulted in the loss of jobs for Americans abroad and in the United States.

The competitive disadvantage of American businesses stems from higher overall employment costs and the inability to retain Americans in responsible and influential positions abroad. The high tax on expatriates is borne, for the most part, by employers. Much of the tax is based upon amounts that are not really compensatory and do not confer any economic benefit upon the employees. This is an added element of cost that foreign competitors do not face.

An exclusion should be provided to reduce the tax cost of sending Americans abroad and to provide an incentive for accepting overseas assignments.

The timing of legislation should be such that unnecessary compliance hardships will be avoided.

Our present system of taxation fails to offer any incentive for Americans to accept positions abroad. Moreover, there is a disincentive in those situations where the higher tax burden is not borne by an employer.

LEGISLATIVE PROPOSALS

The legislative proposals introduced by Senators Chafee, Jepsen, and Bentson are responsive to the urgent need for enactment of new tax rules to place U.S. taxpayers abroad on a comparable taxation and competitive basis with citizens of competing industrial nations. Each of these bills would, in application, very likely reduce our expatriates' U.S. tax burden from its current level, encourage Americans presently overseas to remain, and promote the likelihood that others would consider foreign assignments. This would serve to enhance the overseas competitive position of U.S. businesses.

A detailed review of these bills, of course, cannot be presented within the time limits for oral comments at this hearing. We therefore intend to submit to the Subcommittee more extensive written comments prior to July 11, 1980.

RECOMMENDATIONS

At this time I will offer the following brief comments summarizing our recommendations for revision of the expatriate taxation rules:

. The inordinately high tax burden on Americans resulting from their foreign assignments should be reduced. Additional expenses required for the maintenance of a comparable standard of living abroad should be deductible for U.S. taxation purposes, thus having a neutral tax effect. In the Foreign Earned Income Act of 1978, Congress attempted to create tax equity between persons employed abroad and in the United States. The deduction mechanism provided for in that legislation (section 913, IRC) would substantially accomplish this goal if it were not frustrated by restrictive regulations and if certain revisions were made, the need for which has become apparent after operation of the new rules for an entire tax filing season. These suggested revisions will be detailed in our letter.

. As pointed out by the President's Export Council report of December 5, 1979, even if the existing tax provisions were to operate in the least restrictive way possible, it remains clear that overseas American citizens and residents would not be in a competitive position with nationals from other countries in terms of taxes. Therefore, we think it is appropriate to couple the deduction for additional expenses of living abroad with a reasonable earned income exclusion to further reduce the higher costs now being borne by U.S. businesses.

. Americans should be encouraged to accept assignments abroad that would put them in positions that would enhance the competitive position of U.S. businesses. The amount of the exclusion should be available for both working spouses so as to avoid a form of "marriage tax."

. As an alternative to the above, we believe an unlimited exclusion would be the ideal solution to the problem of meeting overseas competition. However, a maximum amount may be required in order to prevent abuses and to achieve passage of maximum measures.

. Many of our trading partners, particularly other members of the General Agreement on Tariffs and Trade, have criticized U.S. tax policies for promoting exports. Those countries do not tax the income earned by their nationals residing abroad. They thereby enhance the competitive position of their companies and increase their chances of expanding foreign contracts. Yet, we fail to utilize this same measure to promote exports, even though those who are critical of some of our policies could not disapprove.

We believe that legislation along the lines discussed above would contribute toward accomplishing desirable goals by providing (1) a flexible income tax equity mechanism that is responsive to the varied cost levels found throughout the world and (2) an exclusion from tax of base salaries for the majority of American employees abroad. This is in the interest of our taxpayers and is critical to encouragement of U.S. overseas business.

We strongly urge the Subcommittee to be sensitive to the effects upon expatriates and their employers of the timing of any significant legislative changes. Twice in recent years (1977 and 1978) taxpayers were faced with approaching filing deadlines while rules affecting their tax returns were still in the making. Partial relief in the form of extended deadlines came only at the eleventh hour, and that was too late to alleviate the administrative burden.

I must emphasize that this situation resulted in extremely high costs - needlessly - for the preparation of income tax returns.

I shall be pleased to respond to your questions regarding my comments. Thank you for the opportunity to appear before the Subcommittee.

SUMMARY OF PRINCIPAL POINTS

STATEMENT OF PETER J. HART

PRICE WATERHOUSE & CO.

SUMMARY OF POSITION

We favor the repeal of section 913 and the reinstatement of an earned income exclusion. We believe the legislation proposed by Senator Jepsen (S.2321) which would allow a complete exclusion for all foreign earned income should be given serious consideration. A full exclusion of income earned outside the U.S. is clearly the simplest and most efficient method of dealing with taxation of Americans working overseas. This method would be consistent with the concept of imposing a tax on the basis of residency, which is followed by most major countries, thereby placing U.S. employees in overseas locations on a closer income tax parity with Nationals of other countries.

The proposals of Senators Chafee (S. 2283) and Bentsen (S. 2418), while limiting the exclusion, would provide positive steps toward remedying the existing problems created by Section 913. In the event a complete exclusion for earned income is not acceptable, we believe these two bills should receive favorable consideration.

PROBLEMS WITH THE PRESENT TAX SYSTEM

Special deductions for certain foreign living expenses, introduced by the Foreign Earned Income Act of 1978, have, based on our experience, fallen well short of their intended purpose of producing tax equity and, in many instances, have created greater inequities than previously existed. In addition, the extensive compliance burdens and resulting administrative costs have caused many corporate employers to reassess their ability to compete effectively and profitably outside the United States.

In our opinion, Section 913 of the Internal Revenue Code is not working for the following reasons:

Housing Expenses

- The Section 913 deduction was intended to provide a deduction for housing expenses incurred in excess of comparable housing costs in the United States. The computation, however, of the housing expense deduction is based not on comparable U.S. housing costs but on a percentage of the individual's artificially inflated earned income. Such "income" elements as excess tax reimbursements and nondeductible moving expense reimbursements which are non-compensatory in nature, are required to be included in the base housing limitation computation, thus severely limiting the deduction. In a majority of the cases with which we are familiar, this rule completely eliminates any housing expense deduction.
- Numerous verification, substantiation and interpretational problems arise in the housing expense area. Determination of the appropriate amount of expenses actually qualifying for the deduction is still the subject of much debate, even though two tax years involving housing expense deductions have now elapsed.

Schooling Expenses

- The determination of this component has proved to be almost as elusive as the housing expense component. For example, the IRS has required the full inclusion of tuition expense reimbursements in income in the year of receipt, but has disallowed a schooling expense deduction for the portion of the tuition payments prorated to days falling in the subsequent tax year. It is doubtful

that Congress intended to complicate the tax returns of Americans abroad to this extent.

Home Leave Transportation

- **The home leave deduction has proved to be much more confusing and much less equitable than originally intended.**
- **The narrow technical requirements of the home leave transportation component operate unfairly to deny many taxpayers a deduction for valid home leave costs.**

Cost-of-Living Differential

- **Although the simplest element of the deduction from a computational standpoint, the COL differential is, in many cases, an inaccurate measure of actual living costs. For example, the COL differential for a family of 4 in the United Kingdom in 1978 was $300. In 1979 the same family of 4 was entitled to a COL differential of $4,500. Such wide fluctuations imply the existence of serious problems in reliance upon the COL table.**

ADMINISTRATIVE COSTS

- **The additional complexities introduced by the Foreign Earned Income Act of 1978 have dramatically increased the direct, as well as the hidden indirect, administrative costs to corporate employers of sending employees abroad. Many corporations have turned to independent firms such as ours to prepare tax returns and tax reimbursement calculations for their overseas employees. The extent and need for these services have greatly increased as a direct response to the compliance requirements of Section 913.**
- **Additionally, the numerous new audit areas introduced with Section 913 have dramatically increased IRS examinations of expatriate tax returns.**

COMMENTS AND SUGGESTIONS ON PROPOSALS

As stated previously, we support the full earned income approach proposed by Senator Jepsen in S. 2321. We also support the provision in Senator Bentsen's bill which would waive the bona fide residence or physical presence tests in cases where the taxpayer is required to prematurely leave a foreign country due to war, civil unrest or similar adverse conditions.

The computation of foreign taxes allocated to excluded earned income should be clearly stated in the legislation. In addition, consideration should be given to indexing the earned income exclusions for inflation.

STATEMENT OF

PETER J. HART, PARTNER

PRICE WATERHOUSE & CO.

PRESENTED TO

SENATE FINANCE COMMITTEE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

HEARING ON TAXATION OF FOREIGN EARNED INCOME

June 26, 1980

My name is Peter J. Hart. I am the National Director of Tax Policy for Price Waterhouse & Co. Prior to moving to Washington, D.C. in September of 1979, I spent two years in Europe where I was responsible for our firm's U.S. tax services in Continental Europe, the United Kingdom and parts of the Middle East with a special interest in taxation of Americans resident in those areas of the world.

I am appearing before this Committee as a representative of Price Waterhouse & Co., an international accounting firm having offices in 90 countries. Our clients include many multinational corporations employing U.S. citizens in all parts of the world. As part of our client services, we prepare tax returns for U.S.

citizens working abroad. For 1979 we are preparing approximately six thousand U.S. expatriate tax returns on a worldwide basis. We also assist employers in planning compensation arrangements for their employees and work with employer and employee alike in making determinations of excess tax reimbursements. In addition to our U.S.-based staff, we employ over 60 U.S. tax professionals (most of whom are Americans) in overseas offices for this purpose.

This statement is submitted in our capacity as concerned professionals engaged in an international tax and accounting practice. We are not representing the interests of any specific company, organization, or individual.

NEED FOR CONGRESSIONAL ACTION

The formulation of equitable tax policy often results in complex and confusing tax legislation. Nowhere is this more apparent than in the taxation of U.S. citizens abroad, especially following the passage of the Foreign Earned Income Act of 1978. This legislation replaced the longstanding earned income exclusion with a special deduction for excess foreign living expenses which, although theoretically feasible, has resulted in a myriad of compliance problems for individual taxpayers, has sharply escalated administrative costs for their corporate employers, and in many instances does not achieve this desired equitable treatment.

The United States is the only major nation that continues to impose an individual income tax on all its citizens regardless of where they live and work. By allowing a foreign tax credit, the U.S. effectively yields to the foreign host country the primary right to tax an individual on the basis of residency.

To the extent the host country tax rate exceeds the effective U.S. rate, an income exclusion approach to taxing Americans abroad without a foreign tax credit would accomplish the same net tax result as exists under current law without many of the compliance complications and administrative costs which have resulted. Should the effective U.S. tax rate exceed the local rate and the income exclusion approach be readopted, the individual's net U.S. tax burden would be reduced; however, any projected revenue loss should be significantly offset by a substantial reduction in the costs to the Treasury to administer and enforce the present system enacted in the Foreign Earned Income Act. The net cost to the Treasury would be further reduced by a decrease in corporate tax deductions resulting from reduced payments for employee tax reimbursements.

OUR POSITION ON LEGISLATIVE PROPOSALS

We favor the repeal of section 913 and the reinstatement of an earned income exclusion. We believe the legislation proposed by Senator Jepsen (S.2321) which would allow a complete exclusion for all foreign earned income should be given serious consideration. A full exclusion of income earned outside the U.S. is clearly the simplest and most efficient method of dealing with taxation of Americans working overseas. This method would be consistent with the concept of imposing a tax on the basis of residency, which is followed by most major countries, thereby placing U.S. employees in overseas locations on a closer income tax parity with Nationals of other countries.

We recognize that a full exclusion approach could be considered by many as an invitation for abuse and perhaps even an incentive for Americans to move overseas. Such concerns, we believe, are unfounded except in unusual instances. Accordingly, we urge chis Committee to seriously consider the enactment of a full earned income exclusion as proposed by Senator Jepsen.

The proposals of Senators Chafee (S. 2283) and Bentsen (S. 2418), while limiting the exclusion, would provide positive steps toward remedying the existing problems created by Section 913. In the event a complete exclusion for earned income is not acceptable, we believe these two bills should receive favorable consideration.

INADEQUACIES OF THE PRESENT TAX SYSTEM

Special deductions for certain foreign living expenses, and a limited exclusion of income earned in a camp, were introduced by the Foreign Earned Income Act of 1978 in an effort to achieve greater tax parity among U.S. taxpayers. The flat income exclusion which existed prior to 1978 was perceived as an arbitrary mechanism insufficient for some and too generous for others. Unfortunately, the replacement system that emerged from the 95th Congress has, based on our experience, fallen well short of its intended purpose of producing tax equity and, in many instances, has created greater inequities than previously existed. In addition, the extensive compliance burdens and resulting administrative costs have caused many corporate employers to reassess their ability to compete effectively and profitably outside the United States, particularly with regard to employing U.S. citizens stationed abroad.

In our opinion, Section 913 of the Internal Revenue Code, which introduced deductions for five categories of expenses into the Code in 1978 is not working. Some of the reasons for this conclusion are presented below:

Housing Expenses

As in the U.S., the largest single expense, other than taxes, incurred by an individual overseas is normally for housing. In view of the extraordinarily high housing costs in many foreign locations, this Section 913 deduction was intended to provide a deduction for housing expenses incurred in excess of comparable housing costs in the United States. The computation, however, of the housing expense deduction is based not on comparable U.S. housing costs but on a percentage of the individual's artificially inflated earned income. Such "income" elements as excess tax reimbursements and nondeductible moving expense reimbursements which are non-compensatory in nature, are required to be included in the base housing limitation computation, thus severely limiting the deduction. Other allowances, such as those for cost-of-living further accentuate the problem to the extent a full offsetting deduction is not allowed under Section 913. In a majority of the cases with which we are familiar, this rule completely eliminates any housing expense deduction.

Another obvious inequity in the housing expense area is an effective denial of a housing expense deduction to individuals who choose to purchase a home abroad rather than rent. This situation most often affects taxpayers with large families. In addition, allowing a moving expense deduction for the cost of transporting furniture yet not allowing the alternative cost of furniture rental clearly (by Regulation) discriminates against the individual who chooses not to move his furniture overseas.

Compounding the inequities are the extensive record keeping requirements and computations necessary to determine whether any housing expenses are actually deductible. For example, all of the following steps are typically required just to compute this one element of the Section 913 deduction:

1. Amounts paid during the taxable year for rent, utilities, insurance, repairs and other housing costs must be determined. If a payment is attributed to a prior or subsequent taxable year, a proration between years is necessary.

2. Each separate payment noted in step 1 must be translated into U.S. dollars at the exchange rate in effect on the date of payment. This step alone may require more than fifty translations.

3. Total "housing income" must be determined. This is total income earned (including allowances and expense reimbursements) while living abroad reduced by allowable deductions.

4. Housing income must be reduced by other Section 913 deductions (schooling expenses, cost-of-living differential, home leave travel expenses, hardship area deduction) as well as the total housing expenses determined in step 2.

5. The amount determined in step 4 is multiplied by 20 percent. The result is known as the "base housing amount."

6. Total housing expenses (determined in step 2) in excess of the base housing amount (determined in step 5) are the deductible housing expenses.

In most cases the resulting deduction is zero.

These steps are further complicated if housing income includes any earned income attributable to services performed in other than the current taxable year. In such cases, comparative hypothetical computations are necessary to determine what the proper housing expense deduction would have been had the income been received in the year of service. A special adjustment to income is then required if prior year housing deductions exceed the hypothetically determined amount.

Verification and substantiation problems have multiplied under Section 913 especially in the housing expense area. In France, for example, cancelled checks are not returned to the payor, thus making it virtually impossible to provide an examining agent with adequate support for rent, utilities and other housing expenses normally paid by check. This is typical of the practical problems we have encountered since the enactment of Section 913.

Numerous interpretational problems also arise in the housing expense area. Determination of the appropriate amount of expenses actually qualifying for the deduction is still the subject of much debate, even though two tax years involving housing expense deductions have now elapsed.

We believe that if a housing expense concept is to be retained it must be simplified. One possible approach would be the use of a table similar to that used in determining the cost-of-living (COL) differential. As with the COL table, the reference point should be the highest cost U.S. city; however, unlike the COL table, the housing deduction table should reflect different levels of earned income. Tables could be developed for each city or area of the world, and would provide the actual housing component of the Section 913 deduction based on the taxpayer's income level. Income for this purpose should include only base salary (i.e., true earned income) not increased by income elements over which the taxpayer has no economic control such as excess tax reimbursements and nondeductible expense reimbursements.

Schooling Expenses

Recognizing the additional expenses that an overseas taxpayer incurs for the education of his children, the Foreign Earned Income Act of 1978 includes a schooling expense component in the Section 913 deduction. This element of the deduction was intended to represent reasonable expenses for the education of the taxpayer's dependents at elementary and secondary levels. In fact, the determination of this component has proved, in many cases, to be almost as elusive as the housing expense component.

For example, schooling expenses are limited to the cost of tuition, fees, books, local transportation, and other required expenses but such costs may not exceed similar costs charged by an adequate U.S.-type school available within a reasonable commuting distance. The determination of such things as an adequate U.S.-type school, or reasonable commuting distance and other required expenses are subjective even with Treasury guidance in the form of temporary regulations. In practice, a significant amount of time and effort is spent on such determinations, in computing as well as defending the deduction, particularly when the return is examined by the IRS.

The IRS has required the full inclusion of tuition expense reimbursements in income in the year of receipt, but has disallowed a schooling expense deduction for the portion of the tuition payments prorated to days falling in the subsequent tax year. This is clearly contrary to established cash basis tax accounting typically used by individual taxpayers. Moreover, it is doubtful that Congress intended such an improper matching of income and expense, or intended to further complicate the tax returns of Americans abroad to this extent, for such relatively minor amounts of income.

Home Leave Transportation

The Section 913 deduction also includes an annual home leave element which consists of the reasonable cost of coach fare transportation for the taxpayer, his spouse, and his dependents to and from his tax home outside the U.S. to his most recent place of residence in the U.S. (or nearest port of entry in the continental U.S. other than Alaska). The home leave deduction has proved to be much more confusing and much less equitable than originally intended, similar in complexity to the other Section 913 components.

Determining the lowest coach or economy fare available at the date and time of travel can be particularly difficult, not to mention frustrating, considering the widely fluctuating fares in the present competitive airfare environment. This determination is normally made when the tax return is prepared which could be more than a year after the home leave trip occurred.

The narrow technical requirements of the home leave transportation component operate unfairly to deny many taxpayers a deduction for valid home leave costs. A number of U.S. citizens working outside the U.S. who consider their home to be other than the U.S. due to a long absence from the U.S. or marriage to a nonresident alien, receive no deduction for their home leave travel. For example, a U.S. citizen living in Venezuela spends his annual home leave with his wife's family in Mexico. In order to claim a home leave deduction he is required to travel through Miami (the nearest U.S. port of entry) enroute to Mexico. No doubt this result was not anticipated when the legislation was introduced but it typifies the kinds of problems encountered by Americans abroad under the present tax system.

Cost-of-Living Differential

A deduction in recognition of general excessive costs of living (i.e., costs other than housing, schooling and home leave) in specific foreign locations is provided in the cost-of-living differential component of the Section 913 deduction. Although the simplest element of the deduction from a computational standpoint, the COL differential is, in many cases, an inaccurate measure of actual living costs.

For example, the COL differential for a family of 4 in the United Kingdom in 1978 was $300. In 1979 the same family of 4 was entitled to a COL differential of $4,500. Such wide fluctuations in a country, as reasonably stable economically as the United Kingdom in 1978 and 1979, implies the existence of serious problems in reliance upon the COL table. This result probably has its origin in the fact that tables are published once a year, reflecting information available at only one point in time during that year.

ADMINISTRATIVE COSTS

The additional complexities introduced by the Foreign Earned Income Act of 1978 have dramatically increased the direct, as well as the hidden indirect, administrative costs to corporate employers of sending employees abroad. With the desire not to interfere in an employee's personal tax affairs, many corporations have turned to independent firms such as ours to prepare tax returns and tax reimbursement calculations for their overseas employees. The extent and need for these services have increased greatly as a direct response to the compliance requirements of Section 913.

Based on a review of 1979 annual proxy statements filed with the Securities and Exchange Commission, professional fees for expatriate tax services have been disclosed to be significant by many registrants. The additional costs to an employer of maintaining an adequate record-keeping system to report in detail amounts paid on behalf of the employee for housing, home leave and schooling are difficult to assess but can be assumed to be substantial.

With the loss of the earned income exclusion, the overseas taxpayer who is not protected by a corporate tax reimbursement plan, or entitled to company provided tax preparation services, is faced with the prospect of either preparing his own return or incurring a substantial sum to have it prepared for him. Considering the complexities introduced by Section 913, he often has little choice but to seek professional assistance.

Greater complexity in the tax return obviously increases the probability of error as well as the possible need for a detailed IRS examination. We understand from our foreign offices that IRS examinations of tax returns of Americans abroad have increased dramatically in the past year. This is not surprising considering the numerous new audit areas introduced with Section 913. The use of an earned income exclusion significantly reduces these problems, not only for the employer and the individual taxpayer, but for the government as well.

COMMENTS ON PROPOSALS

General Suggestions

As stated previously, we support the full earned income approach proposed by Senator Jepsen in S. 2321. We believe that such a change would significantly simplify the taxation of overseas Americans leading to lower employer costs and, logically, increased American business presence abroad. In addition, such an approach positions U.S. citizens abroad in an equivalent tax position with their foreign counterparts, thus providing less of an impediment to competition.

The modified exclusion approach proposed by Senators Chafee and Bentsen would remove much of the complexity inherent in the present system without changing the fundamental principle of individual taxation based on citizenship. Income now protected from double taxation in small part by the Section 913 deduction and in large part by the foreign tax credit would, instead, be protected by an earned income exclusion. Accordingly, we support the proposals of Senators Chafee and Bentsen in the event Senator Jepsen's proposal is not considered a viable alternative to Section 913.

We also support the proposals of Senators Chafee and Bentsen that would grant a housing expense deduction in addition to an earned income exclusion; however, in the interest of simplification and equity we would strongly urge that such deduction be determined either by reference to housing deduction tables as outlined previously or as a percentage of a true earned income figure (i.e., earned income less non-compensatory income elements such as tax reimbursements and nondeductible expense reimbursements).

We would also like to emphasize our support for the provision in Senator Bentsen's bill which would waive the bona fide residence or physical presence tests in cases where the taxpayer is required to prematurely leave a foreign country due to war, civil unrest or similar adverse conditions. Although future reliance on such a waiver should be rare indeed, the civil unrest in Iran, which affected many of our clients, points incisively to the need for such a provision. Corrective legislation covering the Iranian situation has been bogged down in Congress for some time.

Some of the other areas that require Congressional action if an earned income exclusion is reinstated are:

1. Determining nondeductible moving expenses related to excluded income;

2. Stipulating whether gross or net income of self-employed persons and partners is to be used for exclusion purposes;

If the exclusion is not reinstated, the following items require attention:

1. Allowance of a deduction for "Excess Tax Reimbusement". A deduction of this nature would eliminate the problem of tax spiral illustrated in Appendix I attached hereto.

2. Clarification beyond question that retirement allowances attributable to foreign service rendered prior to December 31, 1962, is, and has been since 1963, fully

excludible in accordance with the relevant grandfather clause contained in the Revenue Act of 1962 (see Appendix II).

Technical Suggestions

The computation of foreign taxes allocated to excluded earned income should be clearly stated in the legislation. Without legislative guidance any one of a number of methods could be used to compute the disallowed foreign taxes. For example, under the Tax Reform Act of 1976 the following formula was prescribed:

$$\text{Foreign taxes} \times \frac{\text{U.S. tax on net excluded earned income plus zero bracket amount}}{\text{Numerator plus the Section 904 limitation}}$$

The temporary regulations under new Section 911, however, prescribe the following different formula:

$$\text{Foreign taxes} \times \frac{\text{U.S. tax on taxable income before exclusion less U.S. tax on taxable income after exclusion}}{\text{Numerator plus the Section 904 limitation}}$$

Other formulas based on income instead of income tax could be used as could a specific identification of foreign tax to excluded income. Legislative guidance is clearly needed.

Indexing the Exclusion

We believe that readopting an exclusion to taxing earned income of U.S. citizens working outside the U.S. would move decisively in the direction of tax simplification compared to the existing special deduction approach. In addition, we believe that in the interest of tax equity the blanket earned income exclusion should be indexed for inflation. The Consumer Price Index or the GNP deflator could be used for this purpose. In the alternative, the IRS could prepare an index for each foreign area based on a standard level of compensation such as the base salary of a GS-12. The exclusion would be calculated as an amount equal to the base salary, multiplied by the index which would be the percentage by which costs in the foreign area exceed U.S.-based costs. This latter suggestion is made on page 87 of the Comptroller Gerneral's Report to Congress on the Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas, dated February 21, 1978.

Washington, D.C.
June 25, 1980

EXAMPLE OF TAX SPIRALING (TAX ON TAX) RELATED SOLELY TO TAXATION OF EXCESS TAX REIMBURSEMENT

	Year			
	I	II	III	IV
Base salary	$40,000	$40,000	$40,000	$40,000
Hypothetical tax	(10,000)	(10,000)	(10,000)	(10,000)
	30,000	30,000	30,000	30,000
Allowances	20,000	20,000	20,000	20,000
Tax reimbursement	-	11,500	17,000	19,700
Section 913 deduction	(5,000)	(5,000)	(5,000)	(5,000)
	45,000	56,500	62,000	64,700
Exemptions	(2,000)	(2,000)	(2,000)	(2,000)
Taxable income	43,000	54,500	60,000	62,700
U.S. tax (rounded)	11,500	17,000	19,700	21,000

Assumptions:

1. All income, allowances and deductions remain constant in all years.
2. No foreign taxes are paid.
3. Taxpayer is married with no children and has not itemized deductions in excess of $3,400.
4. 1979 tax rates are used for all years.
5. Tax reimbursement is paid in the year subsequent to the applicable tax return year.

Observation:

This spiraling of tax will accelerate even more if foreign tax reimbursements are also received.

UNINTENDED EFFECT OF THE FOREIGN EARNED INCOME TAX OF 1978 ON TAXATION OF EARNED INCOME ATTRIBUTABLE TO SERVICES PERFORMED PRIOR TO JANUARY 1, 1963

Background

Prior to the Revenue Act of 1962, Section 911 of the Internal Revenue Code provided that amounts received from sources without the United States which constitute earned income attributable to services performed by a U.S. citizen who was a bona fide resident of a foreign country were not included in gross income and were exempt from taxation. Earned income for this purpose included deferred compensation paid after retirement as a retirement allowance.

Amendments to Section 911

The Revenue Act of 1962 placed a first time limit on the exclusion of income earned by a foreign resident. This Act contained an exception to the limitation (Section 11(c)(1)(B)--an effective date provision) for deferred compensation attributable to foreign services performed on or prior to December 31, 1962, provided the recipient had a right to such amounts on March 12, 1962. This Act also provided an exception (Section 11(c)(2)--an effective date provision) to amendments to Section 72(f), relating to special rules for computing employee's contributions in connection with annuities. Employer contributions after December 31, 1962 were no longer considered part of employee's contributions by reason of the application of Section 911, unless services were performed before January 1, 1963.

Subsequent amendments to Section 911, prior to the Tax Reform Act of 1976, clearly did not affect the "grandfather clauses" of the Revenue Act of 1962. The postponement of the application of provisions of the Tax Reform Act of 1976 retained the status quo through December 31, 1977.

The Foreign Earned Income Act of 1978 changed Section 911(a) from an exclusion for earned income from sources without the U.S. to an exclusion for foreign source income earned by individuals in certain camps for taxable years beginning after December 31, 1977. The Act did not mention the March 12, 1962 grandfather clause. Section 209(c) of this Act did provide for a one time election of the application of prior law (the never previously implemented Tax Reform Act of 1976) for calendar year 1978.

One of the changes embodied in the Tax Reform Act of 1976 affected the computation of tax on nonexcluded income. The effect of this change was to tax an individual's other income at the higher rate brackets which would have applied if the excluded income were not so excluded (i.e., the exclusion was "off the bottom").

Among the changes made by the Foreign Earned Income Act of 1978 was a rule that excluded income is not taken into account in computing the tax on the taxpayer's other income (i.e., the exclusion is "off the top"). In recognition of this change, the recently enacted Technical Corrections Act of 1979 provided for the use of tax tables by taxpayers electing the exclusion effective for taxable years beginning after December 31, 1977. This provision is not applicable for any taxable year for which an individual elects to be taxed under the Tax Reform Act of 1976.

Analysis of the Effect of Subsequent Legislation

It does not appear that Congress deliberately intended to terminate the March 12, 1962 grandfather clause and subject to tax the previously excluded income of a dwindling number of taxpayers who relied on that provision for over fifteen years. It also does not appear that Congress intended to increase the tax for 1978 on the other income of such individuals by taking the exclusion "off the bottom" for such years.

These assumptions are based on the premise that the Revenue Act of 1962 permanently excluded from taxable income deferred compensation attributable to pre-1963 services to which an employee had a right on March 12, 1962. Subsequent legislation in 1964, which modified (but did not repeal) Section 911, made no reference to the grandfather clause, and, in fact, no reference was needed, as these amendments affected only post-1962 earnings.

The Tax Reform Act of 1976 likewise only amended Section 911, however it made no reference to the grandfather clause. (Again, these changes affected only post-1962 income.) The House bill relating to the 1976 Act, entitled "Tax Reform Act of 1975", differed from the subsequent Senate bill in that it phased out the Section 911 exclusion entirely, replacing it with a deduction for certain educational expenses together with an exclusion for the value of certain employer-supplied services. The House bill would have repealed Section 911 effective for taxable years after December 31, 1978, but its effective date provisions contained a savings clause for the March 12, 1962 grandfather rule.

The Foreign Earned Income Act of 1978 is the most recent and significant change to Section 911. This Act also did not include a savings clause for the March 12, 1962 grandfather rule.

Although the Act revised the basic nature of Section 911, its provisions were nonetheless amendments to rather than a repeal of Section 911. Accordingly, based on the manner in which previous amendments were handled, a specific savings clause should not have been required. Any revision to Section 911, no matter how extensive, would apply only to post-1962 Section 911, leaving pre-1962 Section 911 intact.

The continued applicability of the March 12, 1962 grandfather rule to 1978 and future years can be further supported by Section 72(f). The Revenue Act of 1962 codified the March 12, 1962 grandfather rule as applied to annuities governed by Section 72, and this section was not changed by the 1978 legislation.

Present Status

Notwithstanding the foregoing analysis, the Treasury Department and the Internal Rvenue Service are of the view that the effect of the 1978 legislation was to terminate the March 12, 1962 grandfather clause, albeit inadvertently. For years subsequent to 1978, the exclusion granted by the grandfather clause would be totally eliminated. For 1978 returns, the exclusion would be available, but the tax on non-excluded income would be increased by considering the exclusion "off the bottom", under the one time election under the provisions of the Tax Reform Act of 1976.

It is difficult to know how many other individuals have been adversely affected by the inadvertent elimination of this provision. While the revenue impact of a restoration of this provision would be negligible overall, failure to restore the provision can represent a sizeable tax burden on individual retirees who, for the most part, are trying to live on fixed incomes in a period of unprecedented inflation.

Recommended Action

The present Section 911 should be amended to clearly indicate that the exclusion for deferred compensation attributable to foreign services performed on or prior to December 31, 1962, provided the recipient had a right to such amounts on March 12, 1962, is applicable for all taxable years beginning after December 31, 1977. In addition, any subsequent amendment(s) to Section 911 should clearly retain this exclusion.

STATEMENT OF MELCHIOR MORRIONE

OF

ARTHUR ANDERSEN & CO.

ON

TAXATION OF U. S. CITIZENS WORKING ABROAD

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

SENATE COMMITTEE ON FINANCE

HEARINGS ON SENATE BILLS 2283, 2321, AND 2418

JUNE 26, 1980

TAXATION OF U. S. CITIZENS WORKING ABROAD

SUMMARY OF COMMENTS

1. We are pleased that Congress is refocusing its attention on important tax policy areas involving the taxation of Americans working abroad.

2. We believe the major tax policy issue involved in taxing Americans working abroad is the declining competitive position of United States companies in world markets. Analyses of data included in our statement indicate that American companies have lost a significant part of the dominant position they occupied 15 to 20 years ago.

3. A major factor that bears on a U. S. company's competitive position in relation to foreign companies is the cost of products and services being marketed in other countries. The cost of maintaining U. S. citizens in foreign locations is often a significant element which must be recovered in sale prices for goods and services.

4. Changes made in 1976 and 1978 in our rules for taxing expatriates have aggravated the problem, particularly since most of our foreign competitors do not tax foreign earnings of their citizens. We clearly are at a competitive disadvantage with these companies.

5. The 1978 tax changes focused on tax neutrality or perceived tax equity. The objective seems to have been that a U. S. citizen working abroad should neither be penalized nor benefited from his foreign assignment. The 1978 changes did not achieve that objective.

6. Basic U. S. tax policy should be to eliminate disincentives that discourage Americans from accepting overseas assignments and that create increased costs for their employers.

7. In lieu of the complex rules adopted in 1978, we recommend the adoption of a simple system that would provide complete exclusion from U. S. taxation for earnings of Americans working abroad. If Congress decides as a matter of policy that there is a major abuse potential, specific criteria should be adopted that would deny the exclusion for certain types of income or classes of taxpayers. Concern over potential abuses should not override the basic tax policy goal of placing Americans working abroad and their employers in a comparable tax position with foreign competitors.

My name is Melchior Morrione and I am a tax partner in the New York office of Arthur Andersen & Co. I am responsible for coordinating the Firm's practice in assisting Americans working abroad on their tax affairs. Our Firm is an international firm of accountants with offices throughout the world. While we have clients, both foreign and domestic, that would be affected by the proposals before this subcommittee, this statement is not made on their behalf and the views expressed are those of the Firm itself.

In the course of our practice in this area, we have had first-hand experience in working with a large number of Americans employed abroad as well as with their corporate and other business employers. We have observed and are quite concerned with the impact that recent changes in taxing these citizens abroad have had on the competitive position of American companies operating in many parts of the world. We are particularly pleased that legislation has now been introduced and is being considered by your subcommittee that would mitigate or eliminate the adverse effects on American business abroad caused by these changes.

I. DECLINING POSITION OF THE U. S. MULTINATIONAL IN THE GLOBAL ECONOMY.

At the beginning of the post-World War II era, U. S. business embarked on an international expansion program under which it became the dominant force in international trade. The expansion of business vistas toward foreign markets progressed from exporting commodities and manufactured products to investment in local manufacturing facilities to better serve distant markets. Advanced technology together with high-quality workmanship and business acumen made the U. S. enterprise the major competitor in the international market place.

During the past decade the economic balance among industrial nations has decidedly shifted. This movement has been caused by many factors including government fiscal policies, upheaval in the international monetary system, and national politics. Unfortunately, the United States Government, by a number of its actions, has impaired the effectiveness of American business in world markets.

The size of U. S. multinational companies and their dominant position in international commerce have caused some critics to perceive them as evil. Distrust has developed and some have felt that steps should be taken to reduce their advantage in world markets.

Furthermore, many contended that foreign manufacturing activities controlled by American companies actually caused a decrease in U. S. jobs, and that corporate operations abroad were little more than an attempt to avoid U. S. taxation. A point not always recognized by these critics is the fundamental importance to the health of the U. S. economy of the U. S. multinational's strong position in international trade.

Over the last few years, changes in U. S. Government attitudes and tax policies have weakened the competitiveness of American companies in world markets, and multinationals based in other countries have quickly moved in to exploit the opportunities available. The downward trend in the competitive position of U. S. companies in relation to foreign companies is demonstrated by an analysis of the 100 largest non-financial companies in the world.

The following table shows that, in 1965, 68 U. S. corporations were among the 100 largest companies in the world, ranked by sales. In 1978, the number of U. S. companies in the top 100 had dropped to 48.

DISTRIBUTION OF THE WORLD'S 100 LARGEST INDUSTRIAL COMPANIES

(Ranked by Sales)

	Number of Companies			
	1965	1970	1973	1978
U.S.-based companies..........	68	63	50	48
Foreign-based companies.......	32	37	50	52
Total companies..........	100	100	100	100

Source: *Fortune*, various issues.

Note: Appendix A provides a summary of the number of companies by country.

If oil companies in the top 100 are excluded, the decrease is from 57 in 1965 to 32 in 1978. This represents a reduction of 24 percentage points, from 66% (in 1965) to 42% (in 1978) of the total number of companies.

DISTRIBUTION OF THE NONPETROLEUM COMPANIES AMONG THE WORLD'S 100 LARGEST INDUSTRIAL CORPORATIONS

(Ranked by Sales)

	Number of Nonpetroleum Companies Among 100 Largest			
	1965	1970	1973	1978
U.S.-based companies.......	57	49	36	32
Foreign-based companies....	30	33	45	45
Total companies.......	87	82	81	77

Source: *Fortune*, various issues.

Note: Appendix B provides a summary of the number of companies by country.

From 1965 through 1978, sales of the 50 largest foreign industrial companies increased 595% (from $68.4 billion in 1965 to $475.6 billion in 1978). The corresponding increase for the 50 largest U. S. companies was only 317% (from $147.2 billion in 1965 to $613.4 billion in 1978). Stated another way, in 1965 total sales of the foreign companies were 46% of the sales of their U. S. counterparts; by 1978, foreign companies' sales had increased to 78% of the U. S. companies' sales.

Most of these large corporations, which compete with U.S.-based companies in world markets, are based in Europe (primarily West Germany) and Japan. The only other major country that showed a decline in competitive position was the United Kingdom.

This data shows that the relative position of the U. S. companies in international markets has declined substantially during the years surveyed. The competition faced by U. S. companies in overseas markets is of substantial economic strength; it seems clear that the large companies outside the United States are growing faster than their U. S. counterparts.

best copy available

The success of non-U. S. multinational companies in penetrating international markets is not accidental. Through excellent research and development and product design efforts, major technological advances, and the backing of their governments in many ways, they have concentrated on the development of export markets which has led to significant contributions to their national economies.

In recent years, there has been a shift in the focus of non-U.S. multinationals from the foreign market to the U. S. market. We have seen major acquisitions of U. S. companies by non-U.S. multinationals not unlike the way U. S. multinationals invested in other countries decades ago. U. S. companies are already experiencing increased competition from the non-U.S. multinational company for the local U. S. market.

While initially the market position held by U. S. multinationals resulted from providing superior products, this advantage no longer exists. In today's world, product cost has assumed increased significance in international trade.

Other governments assist their companies in penetrating export markets by a number of direct export incentives. These include long term credits, low interest financing, elimination of tax (usually VAT) on exported goods and services, and favorable taxation on income from foreign operations controlled by domestic companies. The combination of these factors and policies has permitted non-U. S. multinationals to offer their products at attractive prices in world markets, and this has enhanced their competitive position in relation to United States based companies.

With the cost of products becoming increasingly important, the U. S. taxation of Americans working abroad becomes a more critical factor for American companies that compete in world markets. As will be discussed later, the tax changes made in 1976 as well as those in 1978 have placed American companies well behind their foreign competitors in terms of the cost of employing U. S. citizens in countries where they wish to do business.

Aside from the cost factor, other policy issues are at stake in this area. In some cases, because of the increased cost of maintaining U. S. citizens abroad, U. S. based multinationals have been forced to replace Americans with nationals of other countries whose tax burdens are considerably less than ours. Once foreign nationals reach management levels in foreign entities controlled by U. S. companies, they can have considerable influence in decisions affecting the purchase of goods and services. Quite logically, they prefer services and products with which they are familiar, and these are usually not of U. S. origin. This factor alone can be significant in lessening the demand for U. S. products.

The global economy is now more homogeneous. National economies are much more inderdependent. Large industrial companies can and do operate on a truly multinational scale in response to the needs of a global economy. It is unlikely that U. S. multinational companies can recapture their former role. They have lost so much ground in the past that they are a decreasingly important factor in the international competitive arena. To restore balance it will take concerted efforts fostered by a supportive government policy. Fundamentally, we need a reduction in disincentives to international expansion. This should start with the adoption of policies which stimulate increased exports and manufacturing activities abroad. We should adopt policies that reduce the cost of maintaining expatriates overseas and create an incentive for Americans to accept assignments abroad.

II. COST OF MAINTAINING EXPATRIATES AT OVERSEAS LOCATIONS

A number of Americans working abroad are self-employed in their own businesses and professions and they must bear directly the economic cost of taxation. However, the majority of working U. S. expatriates are employed by U. S. multinational companies. For this reason, the U. S. taxation of Americans working abroad is a matter of considerable corporate and business interest.

Because of prevailing compensation programs that reimburse the U. S. employee for any increased tax burden suffered as a result of accepting a foreign assignment, the extra tax cost incident to an expatriate assignment is borne primarily by the U. S. employer. This excess cost is usually passed on to customers in pricing U. S. products or services in overseas markets.

In considering the competitiveness of U. S. companies operating abroad, it must also be recognized that most multinational companies of whatever country provide their expatriate employees additional benefits while on foreign assignment to compensate them for duplicate or higher costs incurred during such assignments. Many also pay premiums based on the location of certain assignments, in order to create a direct incentive to attract employees to accept them. In the case of non-U. S. multinational companies, this premium is often the absence of income tax in the expatriate's home country. In the case of a U. S. multinational employer, however, this opportunity is not available, since U. S. expatriates are subject to tax on their worldwide income. This means that the U. S. based multinational has a higher cost of maintaining U. S. employees abroad than is the case for non-U. S. multinationals. The burden and the adverse consequences of this fall on the U. S. company and ultimately on the U. S. economy.

The recognition and evaluation of this added cost to U. S. multinational enterprises has had a significant impact on their activities. It has caused many of them to reexamine the cost of retaining U. S.

employees abroad and to reduce significantly the number so employed by replacing them with local national or third-country national employees. Further, U. S. based companies have lost opportunities for work because their competitors are not required to factor this increased cost into prices quoted for their goods and services.

We believe that efforts by the U. S. Government to eliminate or correct perceived abuses in expatriate taxation and to achieve alleged equity goals have resulted in overkill. As indicated earlier, the U. S. position in the international marketplace is deteriorating. Unless positive action is taken to reestablish a foundation for U. S. multinational companies to resume a leadership role in world markets, the U. S. economy may be subject to increased penetration and control by foreign multinationals.

III. EFFECT OF FOREIGN EARNED INCOME ACT OF 1978

The objectives of the 1978 changes in U. S. rules for taxing citizens working abroad are not clear. While it was obvious that the onerous changes made by the 1976 Reform Act were too harsh and should not be permitted to become effective, there was no clear agreement on the appropriate tax policy to apply to expatriates.

Tax Neutrality

A number of Congressional leaders believed that Americans working in some foreign locations were incurring extraordinary living costs and should be entitled to deduct all or a portion of such costs (I.R.C. Sec. 913). Granting such deductions was intended to place these expatriates in a position roughly comparable to U. S. citizens working at home. Therefore, this approach was designed to achieve greater equity between Americans working at home and abroad.

It was also recognized that expatriates are frequently reimbursed by their employers for extraordinary living costs or are provided housing or education for their children at the employer's cost. What many failed to appreciate is that most U. S. multinational companies have income tax reimbursement or equalization programs for expatriate employees. Such programs reimburse an expatriate for the additional income tax which he incurs by reason of the foreign assignment in excess of the tax he would have incurred had he remained at home.

A typical expatriate compensation package, in addition to the usual elements of housing, educational allowances, home leave, and incentive premiums, all of which are usually taxable in the U. S. as well as abroad, will include a reimbursement for additional income taxes that will be incurred by the employee. A major objective has generally been to achieve tax neutrality in the expatriate compensation package, so that the employee has neither a benefit nor a detriment as a result of a foreign assignment. The combination of base salary, a series of allowances, and tax equalization reimbursements has simply increased the cost to an employer of retaining a U. S. employee in many parts of the world.

The 1978 legislation created certain deductions, generally equivalent to allowances paid to U. S. Government employees on foreign assignment which are exempt from taxation. These allowances are not competitive with those required to be paid by U. S. multinational enterprises. Consequently, the 1978 series of deductions in total does not approach the amount of benefits required to attract U. S. citizens to accept assignments in many parts of the world.

As stated above, while the 1978 changes were intended to achieve some perceived tax equity or neutrality, the net result has simply been a substantial cost increase to employers for attracting and retaining U. S. citizens abroad.

Incentive for Foreign Employment

In the development of the 1978 legislation, Congress showed some concern about the need for an incentive to encourage Americans to accept employment abroad, but this does not appear to have been a major factor. Subsequent to enactment of the 1978 changes, considerable support has developed for adopting tax policies that would create such an incentive. For reasons beyond tax equity or neutrality for the employees who are directly affected, Congress should establish a system for taxing such employees that would encourage employers and their employees to develop a stronger U. S. presence abroad. This should enhance opportunities for expanding export markets and, in the final analysis, contribute to the U. S. economy both domestic jobs and foreign source funds to reduce our balance of payments deficits.

Complexities of Current Law

The series of special deductions included in the

1978 legislation was premised on the types of extraordinary costs normally incurred by U. S. expatriates. Although this system appeared more precise than the former flat dollar exclusion, and therefore was expected to be more equitable, it generally resulted in a much smaller overall tax benefit than the actual expenses incurred by or on behalf of the taxpayer for these costs. In fact, the 1978 law imposed a series of burdensome record keeping and substantiation requirements on both expatriate taxpayers and their employers. This has resulted in additional fees for professional services, and will cause greater problems for the Internal Revenue Service in auditing expatriate returns.

In our experience in working with many expatriate taxpayers, we have found that they have great difficulty in understanding and appreciating the need for increased documentation, which far exceeds requirements for citizens employed in the United States. Among the complicating areas involved in the present law are the following:

1. Proration Complexities

Schooling expenses are considered not deductible in the year paid to the extent they are attributable to periods after the end of the tax year. Frequently, tuition and room and board expenses are paid in advance, and the normal school year spans the end of the taxpayer's taxable year. Proration of school costs is required based on the number of school days in each taxable year. This in essence places cash basis individual taxpayers on the accrual basis insofar as schooling expenses are concerned and creates an unnecessary complexity.

The determination of the cost-of-living allowance for a family whose size varies during the year must be computed separately for each portion of the year. If a move is made from one foreign country to another, different rates may apply for different portions of the year. The record keeping requirements to make these proration calculations are burdensome and confusing.

2. Qualified Housing Deductions

The housing deduction is perhaps the most illusory of the deductions enacted in 1978. It is premised on the theory that an individual would normally spend one-sixth of his income for housing. More specifically, a deduction is allowed for housing costs which exceed 20% of an expatriate's worldwide earnings exclusive of actual housing costs incurred. While for this purpose, worldwide earnings are also reduced by other special deductions allowable under IRC Sec. 913, the difference between the amount of the deductions and the allowances from the employer do not reduce earnings for purposes of this limitation.

For example, tax equalization reimbursements which are paid to keep the employee whole and do not represent an economic gain to him, increase the base to which the 20% factor applies. This seems to violate the objective originally sought, in that the one-sixth approach should apply only to real income and not to income inflated by reimbursements or allowances. The value of this deduction has been seriously impaired.

A further reduction and added complication in the housing deduction is caused by recapture provisions. Under these rules, income is required to be recomputed from a cash received to an accrual basis to determine whether a housing allowance in a prior year should be reduced. For certain compensation payments, it is often difficult to establish the years with respect to which services were rendered. Thus an expatriate who receives a housing deduction in one year may have it recaptured in subsequent taxable years, based on payments received in later years.

The housing expenses to be considered do not include the cost of furniture rental or insurance on personal property. For many countries, the amount of rent attributable to furnishings or an allocation of insurance between real and personal property is impractical, since these amounts are not readily available nor can they be easily determined.

3. Qualified School Expenses

This deduction is limited to the lowest cost of any adequate U. S. school within a reasonable commuting distance from the taxpayer's foreign home. This requirement increases the complexity of obtaining information and documentation for taxpayers having more than one such U. S. type school available.

4. Home Leave Deduction

A deduction is allowed for transportation expenses back to a taxpayer's present or most recent principal U. S. residence, or the port of entry nearest to a taxpayer's current tax home. Quite often, expatriates will have severed ties which existed prior to their foreign assignment and have no reason to return to their last residence in the United States. Accordingly, they may return to other locations in the United States during annual home leave. Determining the allowable transportation expense under these circumstances is confusing and burdensome.

The points noted above highlight the burdens and undue complications being imposed on expatriates in filing their annual U. S. tax returns. While tax simplification has often been a significant consideration in the development of our tax laws, the 1978 system for expatriate taxation has been complicated far beyond expectations. It is little wonder that American citizens abroad are confused by the tax laws they must deal with. While the normal individual taxpayer in the U. S. has difficulty in understanding and completing his annual Federal tax return, the requirements placed upon American citizens abroad go far beyond the form itself. The end result does not seem to justify the complications that have been created.

IV. COMPETITIVE POSITION OF U. S. COMPANIES -- THE DOMINANT TAX POLICY ISSUE

In testimony before Senate Finance Committee hearings on the "Taxation of Americans Working Abroad" in May of 1978, Comptroller General Elmer Staats, after summarizing the results of a survey conducted by the General Accounting Office, referred to the seriousness of the deteriorating U. S. economic position, and the relatively few policy instruments available for promoting U. S. exports and commercial competitiveness abroad. He stated:

> "Our concern is based upon a fundamental belief that, to maintain and build upon the competitive position of the United States, it is essential for a large force of U. S. citizens to be maintained abroad to promote and service U. S. products and operations.

> "The Congressional Research Service recently made an analysis of the section 911 tax incentive. They concluded that the incentive is contrary to the principles of both tax neutrality and tax equity and dismissed the adverse impact on trade because its relationship is indirect and uncertain. The CRS study addresses itself primarily to the equity question, while we believe the overriding issue to be trade and export promotion. Moreover, we believe our in-depth study provides concrete evidence of the direct relationship of the tax incentive to maintaining and enhancing U. S. exports." (Underscoring added.)

In observing the import/export position of the United States in the international economy, the GAO report stated:

> "...the United States must remain competitive. To do so, it is essential to maintain a large force of U. S. citizens abroad to promote and service U. S. products and operations."

A Task Force of the Subcommittee on Export Expansion of the President's Export Council submitted a report to the President on December 5, 1979. In referring to the U. S. system for taxing Americans working abroad, the Chairman of the Export Council stated:

> "The Foreign Earned Income Act of 1978 has done little to alleviate the problems of differences in tax treatment between American citizens working overseas and their counterparts from competing industrial nations. The result has

> been that third-country nationals, who generally do not have the burden of paying taxes in their home countries on their foreign earned income, are employed instead of American citizens. This has brought about a sharp loss in the U. S. share of overseas business volume in vital economic sectors, largely because third party nationals tend to specify equipment manufactured in their home country, whereas American citizens would specify and order U. S. equipment with which they are most familiar."

V. CONCLUSION

In our role of providing professional tax services to many U. S. multinational companies as well as a significant portion of the U. S. expatriate community, our Firm has experienced a genuine concern over the impact of our rules for taxing Americans working abroad. We have seen a heightened awareness by multinational companies of the high cost of maintaining U. S. citizens overseas. We have seen significant reductions in the number of U. S. expatriates at foreign locations. We are aware of companies planning to reduce in the very near future the number of Americans employed abroad. These actions are being taken because the extra U. S. tax cost that must be incurred on behalf of an American expatriate seems no longer cost-justified.

The expatriate tax legislation enacted in 1978 should be reconsidered in light of the eroding competitive position of U. S. companies in international commerce.

- If we are to stimulate exports to maintain our trade balance, U. S. "salesmen" should be in the marketplace.

- If the prices of our products are to be competitive, we should not saddle our enterprises with a higher labor cost (in the form of additional tax burdens) which our competitors do not incur.

- If we are to compete effectively in international markets, we need to eliminate present disincentives caused by our taxing policies that made Americans reluctant to accept employment abroad.

To achieve equality with non-U.S. multinational competitors, insofar as the tax burden on employees abroad is concerned, a system of complete exemption from U. S. taxes for income earned abroad by U. S. citizens should be adopted. We realize that an unlimited exclusion, which for some time was U. S. tax policy, was reduced to a flat dollar amount to avoid certain abuses that had occurred. If Congress decides as a matter of policy that, because of the potential for abuse, certain types of income or classes of taxpayers should not be granted complete exclusion, specific criteria should be adopted that would define such types of income or classes of taxpayers. We do not believe that concern over potential abuse situations should override the basic tax policy goal of placing Americans working abroad and their employers in a comparable tax position with foreign competitors.

As an alternative, we support the restoration of a flat exclusion approach, but with an amount more realistic at today's inflated price levels, as compared with the $20,000 limitation first adopted in 1953. An exclusion in the $60,000 to $75,000 range would appear to cover the earned income of a large proportion of expatriates on foreign assignment for U. S. multinational companies. The restoration of such an exclusion approach, when compared to the complications under the 1978 changes, would eliminate a substantial part of our present tax disincentives to accept employment abroad, and would work toward the goal of simplifying the tax system for employers and employees alike.

We appreciate the chance to submit our views on this important area of tax policy, and we urge favorable action by the Congress on these proposals that would make American business more competitive in world markets.

APPENDIX A

DISTRIBUTION OF THE WORLD'S 100 LARGEST INDUSTRIAL COMPANIES

(Ranked by Sales)

	Number of Companies			
Country	1965	1970	1973	1978
United States	68	63	50	48
West Germany	12	10	12	14
Japan	2	8	11	9
France	3	3	9	10
United Kingdom	9	7	6	6
Italy	2	3	3	3
The Netherlands	1	2	3	3
Other	3	4	6	7
Total Companies	100	100	100	100

Source: *Fortune*, various issues.

APPENDIX B

DISTRIBUTION OF THE NONPETROLEUM COMPANIES THAT ARE AMONG THE WORLD'S 100 LARGEST INDUSTRIAL CORPORATIONS

(Ranked by Sales)

	Number of Companies			
Country	1965	1970	1973	1978
United States	57	49	36	32
West Germany	12	10	12	14
Japan	2	8	11	8
France	3	2	7	8
United Kingdom	8	6	5	5
Italy	2	2	2	2
The Netherlands	1	2	3	3
Other	2	3	5	5
Total Companies	87	82	81	77

Source: *Fortune*, various issues.

Senator **Chafee**. Mr. Sundberg.

STATEMENT OF ANDREW SUNDBERG, DIRECTOR, AMERICAN CITIZENS ABROAD, MANAGING DIRECTOR, CONSULTE, S.A., GENEVA, SWITZERLAND

Mr. **Sundberg**. Senator, my name is Andrew Sundberg. I caught a plane very hastily yesterday to fly over from Geneva to have a chance to talk to you and your panel. I find that I seem to be the only person here who is actively representing individual American citizens, those who are on the front lines but who are not necessarily defended by a corporation willing to protect them and shelter them from tax.

I am talking about the people who are really suffering overseas, the poor, the retired American, the American school teachers, the persons who are trying to act as entrepreneurs, trying to represent their country, and trying very hard to promote, particularly in many of the developing areas of the world, the values that we used to believe in: the belief that the individual really counted, the values, such as equity, that really meant something in a very large sense.

I find to my amazement, having lived overseas for the last 12 years, that the United States has recently become the laughingstock of the world. I will tell you how I came to this rather stunning, and to me very, very disappointing conclusion.

I manage a small economic research company. Two years ago we carried out a comparative survey of how eight countries treat their citizens working abroad, and this is across the board. This study covered taxes as well as the other obligations, rights, and benefits that expatriates carry with them when they leave their home country. I would like to introduce a copy of this for the committee's use.

Senator **Chafee**. Thank you.

Mr. **Sundberg**. I am also involved in trying to help overseas Americans defend themselves. Two years ago I help to create an organization called American Citizens Abroad, which has now started to link people in over 50 countries throughout the world, including some of those who write to us from behind the Iron Curtain.

These are individual American citizens, not those who are being protected by chambers of commerce or by major corporations. These are the individuals who are out there, the ones who manifest or should be manifesting the great values and virtues that our country once stood for.

When I compared the eight countries that we covered in this particular report: the United States, West Germany, Great Britain, France, Italy, Sweden, Switzerland, and Japan, I found that there are really two approaches to what the expatriate is about.

One says that the expatriate is an asset. One says he is a liability. To my knowledge, every major country of the free world, except the United States, considers its overseas citizen to be an asset, and the whole orientation of their policy is basically asset management, optimum asset utilization. The United States alone, among all of the major countries of the world, tends to consider its overseas citizens as a liability, and the whole orientation of its approach, politically, socially, and concerning human rights and every other case, is to control the risk and limit the potential danger to the United States from the American who is abroad.

This is really quite extraordinary. We hear over and over again that for reasons of equity Americans overseas should be paying tax because Americans at home are paying tax. Furthermore, we find that we are supposed to carry these obligations with us throughout the world, despite the fact that nobody seems to care about our rights or our benefits.

Some of those among us have children who are born stateless, Senator. On their birth certificate it says, "This child is a displaced person." No nationality, and the parents are American.

Some of those among us overseas have spent their whole working life paying U.S. tax, contributing to social security, but they have no medicare. Why no medicare? They happen to be abroad and those benefits don't follow them overseas. But, of course, their obligations do.

Some among us have special rules that apply to receiving social security retirement benefits. Again, the rules are different for those overseas. Why? Because the situation overseas is very complicated. You are dealing with complexities of exchange rates and specific local rules for 180 different countries. It is just impossible to try and set the same standards abroad as we have at home.

I found, in comparing the way these eight different countries treat their overseas citizens, that a rather paradoxical thing occurs. Even if we did away with the taxation of Americans overseas, most Americans abroad would still be behind the 8-ball from a competitive point of view. I am talking now not only of tax on earned income, but I am talking of tax on unearned income.

Not only are we the only country in the world that taxes earned income, we are the only country in the world that taxes unearned income of our citizens abroad. Because of the rather curious nature of what we call unearned income, when those who work finally retire overseas, their retirement income is called unearned. The people who have a bit of their income sheltered while they are working suddenly find themselves totally exposed.

I have been dealing recently with a number of senior American executives who are about to retire, and many of them rather tearfully are saying, "The only way I can go on living here is to give up my American citizenship. I cannot afford it. None of my unearned income is going to be sheltered."

There is nothing. There is no deduction. There is no compensation. There is no cost-of-living allowance. There is no housing allowance. There is nothing from the day you stop working. From the day you retire, you are fully exposed. On the other hand, when you turn 65, having contributed to social security, you are not going to get any medicare. Why? Because you are abroad. But, sure, you will go on being taxed, and you will be fully taxed with no shelter. Again, we are the only country in the world that does that. Nobody quite knows why.

I can understand an equity argument, when you say, "Of course, you are an American overseas. You pay the same burdens." But, where are my benefits? "You don't get those because you are abroad. Your child is a suspect because he is born overseas." We are still living with the McCarran Act, and that treats many of our citizens as a danger, and in fact some children don't get citizenship at all.

Senator **Chafee**. Wait a minute. I surely did not know that the child of an American citizen born abroad does not in some way have American citizenship.

Mr. **Sundberg**. We have instances all the time, Senator. I heard from an American the other day in Brussels. The American father himself was born in New York. He has been living now in Belgium for a number of years. His child was born recently, and his child's birth certificate says that this child is stateless. He is a displaced person.

Our rules are rather strict. In fact, we make pious comments about how we really would hope all countries of the world would observe better human rights for their own citizens. Two declarations on human rights have emerged from the U.N.—the declaration on human rights and the declaration on the rights of the child. Both solemnly call on those who claim to adhere to them to guarantee that a nationality will be given tc a child at birth. Unfortunately, the United States doesn't go along with that.

Senator **Chafee**. Those are real problems, and I am not dismissing them. But we really have got to restrict our comments to the legislation here before us.

I think that you can present a particular view as representing individuals. For example, you mentioned retirees. Well, we can't wrestle with them either at this particular time because this statute solely deals with earned income, and we are concentrating on the problem of exports and jobs.

I am not saying that the problems you raise are not significant. They are, but I would like to hear further your thought on individuals as they are connected with this legislation.

Mr. **Sundberg**. Senator, I fully understand that.

Let's compare the problems of individual Americans trying to compete overseas for a job against citizens of other nations of the world, who are not taxed on either earned or unearned income. I said earlier that even if we did away with the full taxation of Americans overseas, many of them would still be behind the eight ball from a competitive point of view.

I have talked with high officials in the French Government. Shortly after the oil crisis, the French equivalent of our chamber of commerce, the Syndicat du Patronat, put pressure on the French Government to study the whole question of how to promote exports from France.

A former minister of the French Government, Andre Bettancourt, was asked to head a blue ribbon panel to look at what could be done to improve French exports, and particularly at how to get more Frenchmen to go overseas.

Mind you, when that study took place, the Frenchman overseas was already not being taxed. But they went about improving the educational benefits of the Frenchman abroad. They changed, and made much more flexible and helpful their social security laws. They changed some of the tax basis for income that was generated at home in France to ease some of the burden for those who were overseas.

I am surprised by another aspect of the bill that you have introduced and the lack of any comment thereon by others here, particularly those representing the construction industry.

When I talked to senior officials in France, in Germany, and in Italy, all of whom have strenuously gone into how to promote exports, I learned that those who are temporarily away from home, yet maintain their residence and domicile at home, who go abroad to work on construction projects in the Middle East, get an exclusion on their earned income.

Senator CHAFEE. Based on a proportion of the year abroad?

Mr. SUNDBERG. All of the income that they earn abroad, even if they are only abroad for a few months. More and more countries are getting into that now.

In other words, these are people who maintain their domicile and residence at home, and their income earned abroad is being sheltered because their home governments want to have their companies in the construction industry competitive, especially in the Middle East.

This means that a Frenchman who goes and works on a construction project in the Middle East, even though he keeps his home and his family living in France, will not be paying any tax to France on the income that he earns while he is working on that project, even though that is only for 3 or 4 months.

This is now true of Germany. It is now true of Italy. And a number of other countries are going to do the same thing. Under your bill there is not going to be any help for anyone who is abroad less than a year, even though you go to the 11 out of 12 months test for physical presence abroad.

Consider that when the Senate first took up this whole question of the exclusion of earned income back in 1926, the rule that was applied then was that only 6 months abroad qualified you for a full exclusion of your income earned abroad. That stayed 6 months until 1942 when Congress decided that you had to have a bonafide residence: a full year abroad.

In other words, we are now way out of step with the other nations of the world. Even our piecemeal attempts to try to rectify some of these problems are not going to put us on a competitive footing even in those areas where the contest today is so critical—in other words, even for the construction companies.

I had dealings with senior officials, as I said, in many countries who told me: "We don't understand the United States. It used to really adhere to the basic economic principles that all factor inputs to a local competitive situation should be competitive and equal."

We have just gone through an exercise of spending years to try to convince the other countries of the world to ease up on the trade laws and promote free trade. Then we saddle our overseas citizens with unique burdens that are not shared by anybody else. We throw an export tax on our own labor. It is amazing. It is unique in the world. No other country that has any sanity in terms of trying to promote itself abroad would ever follow in this example.

Senator CHAFEE. Your trip has been worthwhile.

Mr. SUNDBERG. I hope so, Senator.

Senator CHAFEE. We appreciate you coming here and giving us these thoughts. I suppose we could go further. I did realize that in

Britain if you were absent a certain portion of the year you could get that portion of the income for that year or what you earned abroad for that time to be exempt.

Somehow we have not had any pressure on that here.

Mr. SUNDBERG. Senator Chafee, that is what surprises me. I have had a lot of conversations with the chambers and corporations overseas. What I come away with is a great revelation and a great disappointment. I hear over and over again that we cannot dare to tell the Congress what is really going on overseas because nobody will go along with a total exclusion of our income overseas. It is not politically saleable.

Yet I tell them, "Look, a couple of years ago, Members of the Congress faced the problem of double taxation, and they very quickly dispensed with it."

Public Law 95-67 addressed the problem of Members of Congress who come to serve in Washington, but who come from States that have local income tax. When they live in Maryland, Maryland wanted to tax them, too, but give them full credit for tax paid elsewhere. Very quickly, the problem of double taxation when it affected a Congressman or Senator was overcome by law, and nobody ever said, "This is not politically saleable."

Senator CHAFEE. There was high motivation there. [Laughter.] Thank you very much. That is helpful. We appreciate you giving us a hand.

Mr. SUNDBERG. I would like to ask also, Senator, if you might want to introduce in the record of your proceedings a report that was prepared by American Citizens Abroad, addressing 63 issues of discrimination against Americans overseas. We have already sent it to the White House and to others.

Senator CHAFEE. We will work that in somehow. I don't know whether we can print it all up, but it will be available.[1]

Mr. SUNDBERG. Thank you.

Senator CHAFEE. Thank you very much.

[The prepared statement of Mr. Sundberg follows:]

---

[1] The report will be made a part of the official committee file.

STATEMENT OF ANDREW P. SUNDBERG

DIRECTOR OF AMERICAN CITIZENS ABROAD

MANAGING DIRECTOR OF CONSULTEX S.A. OF GENEVA, SWITZERLAND

My name is Andrew Sundberg. I am an American citizen, born in New Jersey and brought up in various States of the United States as well as in Japan, West Germany and France. I am a graduate of the U.S. Naval Academy, and of Oxford University in England. I have been living in Geneva, Switzerland for the last twelve years where I am the Managing Director of an international consulting company. I am one of the founders of American Citizens Abroad, an organization that now links individual Americans living abroad in over fifty different countries.

I have stated my background to give some idea of the exposure I have had to life in the United States and abroad. To complete my justification for feeling qualified to give some uniquely useful contributions to this Committee I would like to add that in 1978, my company carried out an extensive research project that involved analyzing how eight of the major trading nations of the Free World treat their citizens who live and work away from home. This report not only focused on the relative obligations of expatriates of the eight different countries, but also addressed the rights and benefits that they each were accorded by their home countries. I would like to offer a copy of this study for the record.

My submission to your Committee today is a brief discussion of the concept of equity and its relevance to the exports of American goods and services, and to the broader category of export of the American way of life to the 180 sovereign countries of the world.

We are here to comment on proposed reform of U.S. tax laws, and how these laws impact on the overseas American. I would like to address my comments to this particular question from what I believe is a much neglected broad policy perspective.

The Congress has been worrying about the question of how to go about taxing the overseas American for almost as long as there has been a progressive income tax in the United States.

In 1913, when the 16th Amendment was finally ratified allowing the Congress to establish such a tax, the amendment rather simply stated: "Congress shall have power to lay and collect taxes on incomes, from whatever sources derived, without apportionment among the several states, and without regard to any census or enumeration." That sounds rather clear. But where does the overseas American fit into this picture and what happens when the overseas American faces taxes elsewhere, or faces competitors who are not subject to any tax at all?

This question remained a rhetorical chestnut until 1926 when the Congress finally decided that in the best interests of promoting exports, and perhaps also the American way of life, all income earned abroad would be excluded from American taxation provided that the

American taxpayer in question had been abroad more than six months of any one tax year.

This exclusion of all overseas earned income was next amended in 1932, when the Congress decided that it should not apply to Government employees abroad who in most cases were never subject to any foreign tax through special treaty provisions. The tax of civilian Americans remained unchanged. There was no such tax liability to the United States for earned income.

In 1942, a decade later, Congress returned to the question and this time decided to do away with the six month rule. Henceforth to be eligible for exclusion of overseas earned income, an American had to be abroad for an entire tax year as a bona fide resident of a foreign country.

In 1951, nearly another decade later, a new look was given to the overseas American and this time the law was amended to allow those who were physically present abroad (but not bona fide residents) to exclude earned income if they were out of the country for 17 out of 18 months in any continuous period.

A mere two years later, in 1953, Congress changed its mind again, and wanted to do away with physical presence rules entirely and go back to only bona fide residence as a qualification for exclusion of overseas earned income. After discussion a compromise was reached limiting the exclusion for those physically present abroad to a ceiling of $ 20,000 per year.

Another decade later, in 1962, the Congress once more felt a necessity to take another look at the overseas American. This time the unlimited overseas earned income exclusion was felt to be an unacceptable good deal. After much debate it was finally decided to reduce the exclusion to $ 20,000 for those who were bona fide residents abroad, and to $ 35,000 for those who were abroad more than three years.

After only two years the debate reopened in 1964, this time with the argument much exacerbated by a wildly misleading article in the New York Times that erroneously claimed that one out of every thirty American taxpayers was living abroad. This time the Congress decided to keep the $ 20,000 exclusion of overseas earned income for those bona fide resident abroad, but to reduce the amount of exclusion for those abroad more than three years to only $ 25,000.

The question then went dormant again until a new reform impetus occurred in 1975 leading to the infamous 1976 Tax Reform Act which essentially gutted the overseas earned income exclusion entirely. This Act offered a $ 15,000 exclusion off the bottom, and gave no credit for taxes paid on the excluded income, effectively making it of no use at all for most Americans living in a country with a local income tax. In addition, with some rather harsh rulings from the Tax Court, many overseas Americans suddenly found themselves facing tax liabilities to the United States that exceeded their overseas monetary incomes. The new rules forced the overseas American to add to his taxable income the full value of all of the housing and other benefits he received from his employer abroad. Thus, if an individual lived in a country where there was no decent local housing, and if the employer had to pay astronomical sums (perhaps $ 40,000 or more per year for an employee earning less than this as a base salary) for a decent home, the American had to declare a taxable income that was perhaps three to four times the amount he actually saw in cash. The result was panic on the part of Americans who lived abroad as private citizens, and panic on the part of companies that had American employees on their payrolls in countries where such extra costs were a necessity. The Treasury Department didn't help anyone in this particular moment because Treasury's estimates of the likely extra revenue that would come from taxpayers abroad turned out to be 1,000% off. Too low, of course.

Inevitably the ridiculous tax situation facing Americans living abroad had to be rectified, and in great haste. Unfortunately many in the Congress had expended considerable rhetorical energy at the expense of the overseas American, and found that it was not easy to eat these intemperate words so soon thereafter. Finally in a rather unique midnight jamboree on the closing evening of the 95th Congress, a new law, the Tax Reform Act of 1978, was passed. This time doing away entirely with any exclusion of overseas income, but substituting in its place an amazingly complicated set of deductions that not even the top American accounting firms can figure out how to manipulate.

Thus, if any historical conclusion is to be drawn from this somewhat tortured question of how to handle the U.S. tax liability of American citizens living abroad, it is that for more than half the life of the U.S. progressive income tax overseas Americans have had their overseas earned income totally excluded from U.S. taxation, but for some reasons that have never been totally clear it has now become politically unacceptable to continue such a practice.

The overseas American has been repeatedly told that the dominant issue involved in deciding what tax burden he should face to the U.S. tax authorities is the question of equity. An American at home has to pay income tax to the U.S. Government. So, therefore, should the American abroad. There should be no incentive in out tax code for an American to leave the United States to live abroad.

The overseas American would not be unhappy with this principle if it were only recognized that taxes are but one of many factors relating to citizenship of the United States, and residence in the 180 different soverign nations of the world. Let me explain.

An American citizen living in the United States not only has obligations to the U.S. Government, he also has a very large basket of rights and benefits deriving from this citizenship. While the principle of shared obligations follows the American citizen abroad, there has never been an equal concern to ensure that the overseas American retain an equal guarantee of rights and benefits as a citizen while he is abroad. And, there has hardly ever been any consideration of the entirely different equity question of how an American working abroad should stand competitively when faced by individuals of other nationalities who would like to have the same job.

I submit to this Committee that no useful resolution of the question of how overseas Americans should be taxed can be undertaken until these broader questions of equity are addressed.

EQUALITY OF OBLIGATIONS AS CITIZENS

Much ado is made about the fact that all Americans should share the same obligations and therefore pay the same tax to the U.S. Government according to the same rules. The fact is, however, that the same rules do not, and can not, apply at home and abroad, even in the simple matter of how tax should be paid.

All individuals working in any town in the United States face the same tax obligations to their local State, and to the Federal Government. All have the same right to the same deductions from their income, and to the same special conditions pertaining to the myriad tax shelter provisions of U.S. tax law that the Congress has seen fit to enact over the years.

When an American moves abroad, he forfeits some rather important advantages under American tax law. For example, the overseas American cannot make a contribution to his local church or school or other charity abroad. All such contributions are taxable. Yet the same contributions made at home would be deductible.

Another example is perhaps much more significant. All U.S. residents can deduct from their Federal taxable income the amount that they have paid in State sales tax, both as a general relief based upon their level of income, and special relief for high-ticket items such as the purchase of a car, or a boat, or a trailer. The American abroad has no such relief. Yet the comparable sales (or equivalent value-added) tax that is paid abroad by many Americans is far higher that what is paid in the United States. Indeed, countries such as France collect more tax per capita each year from regressive taxes such as the value-added tax than they collect from direct taxation of income. The United States, in its own peculiar form of tax equity, simply chooses to call such tax, not a tax, for purposes of either a credit or even a deduction from U.S. taxable income. Many overseas Americans view this attitude as official fraud.

Not to labor the point it should also be added that the overseas American has little local help available in understanding the tax requirements and in completing the U.S. tax forms properly, let alone trying to marry these requirements with the entirely different and incompatible tax laws of his overseas country of residence. Further, just to make the point more vivid, the Congress and the Administration refuse to give the IRS sufficient funds to provide toll-free telephone access to IRS help, as is available in the United States. The grounds for this refusal is that money must be saved and the overseas American should be willing to make this additional sacrifice.

Let us put aside some of these minor irritations in the present way the law is being implemented and turn to some more serious problems that overseas Americans face.

There is no foreign country which has a code of tax law that is fully congruent with the tax practices of the United States. That means that Americans, no matter where they might live, are constantly being subjected to two incompatible systems of taxation.

The usual reaction of the Congress and the Administration is to dismiss this as irrelevant because the United States is willing to give full credit for income taxes paid abroad and this avoids any double taxation. As explained earlier, however, it does not avoid double taxation, it merely reduces double taxation under U.S. definitions of what income tax should be. If the overseas country chooses to collect tax in a form that is not familiar to the United States, the Congress and the Administration have chosen to simply ignore the novel taxes that have been chosen by the sovereign states abroad. This, of course, is necessary for sanity and to avoid having to emit rules for countless special cases that are created by constantly changing tax philosophies in the 180 sovereign countries. But having ignored such subtlties, the result is that the overseas American is then exposed to many forms of real double taxation that have simply been defined out of existence by the United States. This is a major form of official tax fraud that the United States has tried to induce other countries into following. For some very good reasons all of the other major countries of the Free World have refused to accept the leadership of the United States in this form of abuse of their overseas citizens. They all recognize that it would be impossible to devise a truly fair form of tax that would recognize the economic realities of 180 different tax systems.

But, so far we have only been dwelling on how the present system works and how it gives major headaches to the American abroad. Let us look at what the Congress offers in the way of relief. Having agreed to ignore much of the tax that Americans really pay abroad in non-American standard methods, the Congress did decide that some relief was in order. This was built upon the theory that the base income of the overseas American should be fully taxable, but some relief could be granted for extra costs that are faced abroad in certain circumstances. Thus, the American that had to pay for a very expensive home could take a deduction for some of the extra cost of this housing, but only to the extent the housing exceeded the cost of comparable lodging in the United States. The law also gives a deduction for the cost of schooling of children when adequate free schooling of U.S. standard was not available as it would be at home. An additional cost of living deduction was granted to those who live in countries where the cost of basic items of consumption exceed the cost of the comparable item at home, and finally there was an extra deduction for the cheapest form of travel to the United States once per year.

Some senior members of the Congress feel that this present law is far too generous and should be amended to make the overseas American have a higher U.S. tax liability.

What does the overseas American get for this tax. Even raising this question annoys many in the United States for it is felt to be beyond question that American citizenship is a priceless treasure and no value can be arbitrarily assigned to it. That would probably be emotionally accepted by all but the most hard-bitten American abroad as well. But that is not the meaning of the question.

An American living at home receives many benefits from the U.S. Government that he probably does not even realize until he moves abroad and sees them disappear. Then the question is rephrased. Why am I, an American citizen, being denied rights and benefits that I should enjoy abroad, and would enjoy if I had remained at home?

For example, many overseas Americans are stunned to find that their children, born abroad, have no nationality at birth, they are political refugees, children without a country. The United States, despite its vociferous calls to the other nations of the world to observe the human rights of all people, will not even adhere itself to the two major UN Human Rights Declarations (the original declaration, and the later declaration on the rights of a child) that call upon all nations to assure that all children have a right to a name and nationality at birth. The United States does not extend the same human rights hand to its children abroad that it uses to pick the overseas pocket for extra tax. The equity equation runs only in one direction. No matter where you go you pay, but your human rights guarantees stop at the water's edge. So much for our children.

Another example. Many elderly Americans living overseas have contributed to U.S. taxes and Social Security for most of their working lives and would be eligible for Medicare if they were in the United States. They are denied Medicate while abroad because, as the President recently told the elderly abroad, the United States must balance the budget. No one has asked the elderly in Ohio, or in Rhode Island, to sacrifice their Medicare benefits to help bring the budget into balance, but that is precisely what the elderly abroad are being asked to do. Yet the Government expects all overseas American senior citizens to pay U.S. income tax, and even has a much harsher surprise in store for these most vulnerable individuals because the U.S. chooses to define their pensions are "unearned" income hence eligible for not one single special deduction as had been allowed when they had been actively employed. Many executives who have spent a good period of their lives abroad, and who now have friends and an established home in a foreign country face the cruel prospect of either facing some significant cut in their expected retirement income through the double tax exposure, or else opting to either ignore their U.S. tax or return home. No other country of the Free World treats its elderly this way, and no one I have ever met admires the United States for what it is doing. So much for our elderly.

A final example. There is considerable expenditure directly from the Federal Budget and indirectly through revenue sharing that goes to help improve the education of American children. The American child abroad, although his parents are expected to continue to have the same tax obligations, will not receive a penny from the U.S. Government for education while away from home. President Carter recently tightened the screws even tighter by urging cost cutting that resulted in eliminating many overseas international schools from the list of those eligible to use the U.S. Military Postal system to expedite and reduce the cost of mailing school materials. Under heavy pressure the Administration finally relented, and now any such school can still have limited access to this benefit provided there is at least one dependent of a U.S. Government employee enrolled in the school. Again, not a penny for the civilian child, but a few pennies of postal savings if a dependent of the government can be found. So much for our children's education benefits.

After examining this edifying spectacle of policy which heaps obligations and liabilities on the shoulders of the overseas American but selectively takes away many benefits and rights because the citizen is not at home, let us compare the overseas American with what happens to citizens of other countries when they live away from home.

Here the surprises do not stop occuring. Not one other major country of the Free World expects its citizens who are resident abroad to pay full tax on earned, or unearned income from overseas sources to their home country. That is indeed rather astonishing, but true. Not one single country feels that this is either desireable or feasible.

What this means, therefore, is that the overseas American is unique in shouldering a double tax burden when he lives in a country that has some form of taxation. If the tax laws of that particular country happen to be very similar to the laws of the United States, the American in question will probably not be too badly off from a tax liability on earned income point of view. He will still be highly vulnerable to being stung by U.S. tax on unearned income, particularly if he happens to confront one of the myriad absurd phantom income cases that can occur through exchange rate movements.

But the American who lives in a country where the local tax code is unlike that of the United States will find that often he has more tax to pay than anyone else living in his same country abroad. In some cases, the actual take home pay can be considerably lower than that of anyone else.

The final case, that causes the greatest competitive hardship is the situation of an American working abroad in a country where there is no local taxation at all. Here the American bears the full force of his unique tax status because local market wages are being set on the basis of no tax on income and the American has to face tax to his home country. This situation occurs in many strategically important areas of the world. For example in most of the countries of the Middle East. Here again, either the American accepts to bear this unique tax liability as an individual, in which case he takes home considerably less money than any of his fellow workers, or he turns to his employer and asks for relief.

If the employer shelters the overseas American from his U.S. tax liability while abroad, thus guaranteeing that all of those working in the same company can take home equivalent amounts of money, the employer starts up the extra expense spiral that soon becomes rather ridiculous. The first year that the employer covers the overseas American for his tax burden passes. The following year, the overseas American must add to his taxable income the additional amount he was paid by the employer to cover his U.S. tax liability. Then his employer must not only pay the U.S. Government the tax due on his second year's salary, but also an additional tax on the reimbursed tax for the first year. And the spiral winds inexorably upward. It does not take very long for the additional tax cost of the overseas American to more than double the base salary he is earning. Inevitably this leads either to the American being replaced by someone of any other nationality for whom no such comparable burden exists, or else the company simply eats profit or becomes non-competitive for the increasingly savage fight for contracts in these markets.

What the United States has done, essentially, is create a unique form of export tax on U.S. labor that guarantees that Americans will never have a chance to be equal competitors for a job in any country abroad where there is a tax system that is not identical to the taxation policies of the United States.

And this is the nub of a very different equity conundrum. In choosing to define equity as the same obligations for those at home and those abroad, one deliberately chooses to ignore the inequity of competitive standing of Americans trying to win the same job when faced with someone whose government does not have an export tax on labor. The American, in an equal qualification contest is guaranteed to lose every time. There is no equal employment opportunity abroad.

THE EXPATRIATE PHILOSOPHY OF OTHER COUNTRIES

The expatriate philosophy of the United States now starts to be defineable, at least in outline. An American abroad carries a full basket of obligations and tax burdens, but leaves many of his rights and benefits at home. So be it. President Carter recently added his own comments on the possible worth of the American in the more qualitative area of contributing to good will and spreading the American way of life abroad. In its haste to dispense with such an irritating concept, the Treasury Department drafted a report for the President to send to the Congress claiming that overseas Americans seem to be doing as much harm to the United States as good, and no overall conclusion could be drawn on this point. President Carter accepted this draft and promptly forwarded it to the Congress. It seems clear, therefore, that American policy, at least for the time being relegates the overseas American to a possible asset only if it can be unambiguously shown that he contributes directly to building exports from the United States. Unless and until this can be shown there is no cause, nor justification, to change the way the overseas American is being treated.

In the turbulent wake of the post-1974 oil crisis, as the world was slowly awakening to the realization that the international economic order had been abruptly changed and all bets were off in the fight for economic survival, major nations of the world took stock of their assets in the world markets and considered how they could strengthen these assets and make them even more useful.

The French, unlike the United States, consider their overseas citizens to be vital assets not only for economic promotion of their goods and services abroad, but also to promote the French way of life. When I spoke with senior members of the French legislature and the French Government they uniformly expressed good-humored amazement at what the U.S. did to its overseas citizens vs. what they were themselves doing for their's. Following the oil crisis, the then-Prime Minister, Jacques Chirac, called for the creation of a special blue-ribbon commission to study the overseas French citizen's plight and recommend what additional measures should be taken to encourage more Frenchmen to go abroad for the good of France. At the time this commission was created the overseas Frenchman was already in a most enviable situation. He faced no French taxation on either his earned or unearned income, but he was being given over $ 90 million dollars worth of subsidized education benefits for this children, he had special social security rights, and most unusually he had the right to elect six full members of the French Senate to repreaent only those who lived outside the territorial and administrative limits of France. One of these Senators lives in New York and represents Frenchmen living in North and South America.

Thus when the special commission set up by Mr. Chirac, under the leadership of Andre Bettancourt, former member of the French Cabinet, made its final recommendations for even more special programs to help the overseas Frenchman it was icing on the cake compared to the weak gruel that the U.S. offered to the American abroad.

An interesting innovation of the French, that has since been followed by a number of other countries, is not only to exclude all income for those who are resident abroad, but also to exclude income earned by Frenchmen working on projects in the Middle East and elsewhere even when such Frenchmen retain their homes and tax domiciles in France. In other words, not only are the regular expatriates free from tax, so are those who only go abroad for a short time when their work is on construction projects. There has been no agonizing about whether to use a 17/18 month physical presence rule, or to reduce this to only 11/12 months. The French have decided to give their firms competing in the crucial construction markets as much help as they possibly can and this includes full exclusion for income earned on projects in these key markets. Even for those Frenchmen who do not qualify for this full exclusion, there is never tax on the extra allowances or cost of living factors that are given to those who go temporarily abroad. So much for France.

Conversations with the German Government reveal attitudes that are quite similar to those of the French. The overseas German is an asset to his country and is to be assisted. While there are some legacies of the last war that make some of this a bit delicate, by and large the German Government has been quite generous with its citizens who live abroad. There is, of course, no taxation of either the earned or unearned income of those who reside abroad. But, the German Government does spend over $ 100 million to provide teachers and facilities to educate the children of Germans who live abroad. There are also special social security programs, etc. So much for Germany.

The record is similar, but on a somewhat different scale for the Governments of Italy, Sweden, Japan and other mature trading nations. None feels any equity justificaiton to try to tax those who live abroad. All are concerned about the equality of competitive opportunity of their citizens in the major markets of the world.

In a few days, the President of Switzerland will address the traditional annual message to the overseas Swiss. There is a particular affection in Switzerland for those abroad. They are called the fifth- Switzerland, a reference to the four domestic ethno-linguistic groups that comprise the country. Neither taxed nor troubled, the overseas Swiss in nonetheless embraced by an enormous affection that goes so far as to guarantee Swiss citizenship to all who have left, even those who have taken up the nationality of another country. They are all welcome home as members of the Swiss community and are considered to be the best single asset the country has in building a better economic future for Switzerland, and in promoting a better understanding of the Swiss way of life. So much for Switzerland.

COMMENTS ON THE LEGISLATION BEFORE THIS COMMITTEE

At the present time this committee is considering several different proposals to once again tinker with the tax laws and change some aspect of their impact on those who live abroad. The analysis has not been easy because the only measure of justification this Committee seems willing to consider is what direct impact this change might have on exports from the United States. This rather simplistic reduction of an enormously complicated problem of incompatible definitions of equity from a domestic and foreign competitive perspective dooms most of what this Committee will try to accomplish to more rhetorical eyewash and jejune claims by the Administration that causal chains that the Committee wants to see cannot be demonstrated.

Not one of the bills that is before this Committee today would even bring the overseas American up to par with his competitors of any other nationality in the confrontation for a job overseas. The overseas American has the undigestable chestnut of incomprehensible taxation of unearned income to contend with.

But even if the best of these bills were to pass, and be amended to include total exclusion of overseas earned and unearned income, the overseas American would still find that because of the thread-bare nature of his benefit package abroad he was still behind the eight-ball.

And, this Committee is paradoxically passing in total silence the crucial competitive problem facing construction firms abroad who have significant labor involvement of a short term nature that would not qualify for any relief under the bills now before this Committee.

RECOMMENDATIONS

I would like to recommend to this Committee, and to the full Congress, that it is vitally important to the country to reject the simplistic arguments that have characterised most recent debate on the overseas American and his proper mode of tax liability. What is called for is some more profound reflection on just what the overseas American really is in terms of his fundamental characteristics as a national asset or a national liability. For far too long the overseas American has been relegated to the liability column and treated accordingly. When confronted with a necessity to justify such action the standard rhetoric is to trot out the weary canard of the high-living squatter on the Riviera who has to be taxed for domestic political tranquility. There are very few such animals, and they are far out-numbered by their counterparts who live exorbitant lives on tax-free municipal bond coupons at home. They are the tried and true red-herrings that reveal the poverty of the defense of our present unenlightened policies.

What is needed, rather desperately, is for someone to show some leadership on this issue, to raise the level of debate to the standard that the urgency of the overseas American competitive problem demands, and to take into consideration the several basically incompatible calls of equity.

There is no form of resolution of the overseas tax question that will simultaneously solve the equity equation between those who live at home and those who go abroad, and at the same time render those abroad equal in their fight against individuals whose home country governments are treating them in a far more indulgent fashion.

When considering the cavalier way in which equity is discarded when it comes to giving out human rights to our children abroad, or to our elderly, or even to the taxpayer when it comes to filling out the tax forms, it seems specious to insist that taxation must remain as a fundamental principle. In the present circumstances it is not really a principle at all but rather a callous farce, a caprice, a whimsy.

Indeed, the Congress set an eloquent example for all of us when it considered and approved in almost indecent haste what became Public Law 95-67. This bill exempts all Congressmen and Senators from having to pay State income tax to any other State than the one from which the honorable members have been elected. There should be no double tax liability for Members of the Congress. We do not dispute this point. Indeed, we heartily agree. Having said this, we also urge that this same principle of the unacceptability of double taxation for those in much more complicated circumstances abroad also be respected. For indeed, if it is politically difficult to help those who are floundering abroad, and thereby the entire country, it is hard to believe that it could have been so easy to legislate PL 95-67. Nihil Obstat Stare Decisis.

Our thanks to this Committee for the most kind indulgence in listening to our submission. Our best wishes for the fruitful continuation of your work. And, we renew our oft repeated willingness to be of whatever additional help we can in trying to cut through this malodorous fog into the light of a new day in which all citizens of all nationalities can once again compete on an equal footing in all of the major markets of the world. Today overseas Americans are shackled to the starting post in many contests. Congress holds the key. And Congress has been fiddling with this key for over fifty-four years.

The 18th Century French philosopher Helvetius once stated that man is born ignorant, he learns to be stupid. It is hard to know what to make of the history of American indecision on taxation of those abroad. I suspect that we have learned very little that is of any practical use today. To hear the debate that still echoes to silly rhetoric and irrelevant canards, Helvetius would only smile. And so do all of those in foreign governments who are happy not to have stronger American competition. We have made their work easy for them. That is only as it should be. We have always been a generous country. Thank you. They do to.

Senator **Chafee**. Now a panel: Mr. Henderson from Textron, Mr. Sink from Reynolds, and Mr. Satterwhite from Enserch Corp. Then we have one panel after this.

Gentlemen, we welcome you.

STATEMENT OF JOHN HENDERSON, SENIOR VICE PRESIDENT, TEXTRON CORP.

Mr. **Henderson**. Thank you, Mr. Chairman.

I am John Henderson. I am senior vice president of Textron at the Washington office here. Textron's business has sales of about $3.5 billion, and slightly under a third of our business is done either export or overseas.

I think that all of us feel like the main speaker at the end of the evening, who ought to just say, thanks everybody, and sit down. I will try to be very brief. I have filed a prepared statement.

Based on our own experience, and the testimony this afternoon, there is a quality in the United States position on taxation of U.S. employees overseas which borders almost on arrogance, an arrogance deriving from our preeminence in the post-war period when Americans were first at everything and first in competition. Clearly we are not now, and the statistics show it.

While you cannot call the Treasury Department's position arrogant, I guess, the suggestion that targeting will solve the problem seems to me to run entirely counter to the trend these days that we want to cut down on regulation and complexity. Again, that has been discussed in some detail today. It seems to me that the idea of targeting would inevitably increase the complexity.

I was also puzzled by Mr. Lubick's point, not only about the pleasures of the Champs Elysees, but it seems to me that he defeated his own point by noting that even if we make these tax benefits applicable across the board, and therefore applicable in Western Europe for instance, and the like, it will have very little effect on U.S. revenues because, as he says, the taxes in those countries are substantially equal to ours anyhow, and the U.S. employee already has the foreign tax credit, or would have had in the absence of a tax benefit of this sort.

Therefore, it seems to me that we need, instead of talking narrowly about issues like targeting in very subjective areas, we need to be standing up vigorously and rapidly to problems of reversing the downward trend in the U.S. competitive position overseas. Therefore, to be adopting a statute like your bill, or Senator Bentsen's, which provides across-the-board benefits.

If it later turns out that this in some respects is slightly excessive, we can adjust it. The Treasury will have been hurt very little, if at all, and, indeed, judging by most of the statistics presented today, the Treasury will really be helped.

Senator **Chafee**. Thank you.

I am sorry. I did not mean to interrupt but does that conclude your statement?

Mr. **Henderson**. No, sir. I would like to speak briefly to an orphan in this area which has not been addressed today, and that is a provision that has affected our Bell Helicopter employees who were in Iran, and the employees of many other companies who were in that country, and which has been dealt with by a bill which has previously been before the Finance Committee, to wit, S. 873, and which indeed has passed the House, as H.R. 5973.

That bill is also incorporated in Senator Bentsen's bill here as, I think, section 1(a)(3).

Senator **CHAFEE**. That would take care of them where they are forced out of the country.

Mr. **HENDERSON**. Yes.

Senator **CHAFEE**. I think that is a good provision. I think that it should be in the bill. I don't know whether, if his bill passed, that would take care of your situation since I am not sure that it would be retroactive.

Mr. **HENDERSON**. That is a little odd because the section provides for only actions after September 1, 1978. The bill as a whole, as you say, is applicable to future years. So that would be dealt with.

Senator **CHAFEE**. Yes.

Mr. **HENDERSON**. In any event, I would hope that that problem is such an extraordinary case of equity that it would be dealt with either as part of your bill, or Senator Bentsen's, or if for some reason those bills should be held up as a special issue this year.

Senator **CHAFEE**. Yes, we certainly will.

Mr. **HENDERSON**. We would stand as one company which supports you and Senator Bentsen in placing a limit, perhaps slightly higher than yours, Senator, rather than unlimited because, despite the last speaker here today and the merit of his argument, I cannot conceive that an unlimited bill would be politically pallatable at the present time.

Thank you, Senator, for hearing our testimony.

Senator **CHAFEE**. Thank you very much, Mr. Henderson.

Mr. Sink from Reynolds.

STATEMENT OF C. JACKSON SINK, DIRECTOR OF DOMESTIC TAX ADMINISTRATION, R. J. REYNOLDS INDUSTRIES, INC.

Mr. **SINK**. Mr. Chairman, I am Jackson Sink, director of domestic tax administration of R. J. Reynolds Industries. I am here today to speak on their behalf. I have an abbreviated statement that I would like to make, and I would like to request that my complete statement be entered into the record.

Senator **CHAFEE**. Yes.

Mr. **SINK**. We thank you for the opportunity to appear before you today. Reynolds Industries, with combined 1979 sales and revenues of $8.9 billion, 114,280 stockholders, 79,487 employees, doing business in more than 140 countries and territories outside the United States, considers the ability to thrive and compete internationally directly related to the placement of competent U.S. employees in our operations.

These employees have greater tax burdens than employees of other nations, and Reynolds pays the difference between its employees' tax burdens as expatriates, and their tax burdens as U.S. based employees.

Reynolds' operating company subsidiaries include three with very substantial foreign operations, employing more than 200 U.S. citizens in over 30 countries.

No. 1, Sealand Service, an ocean common carrier, serves more than 122 ports in over 45 countries, serves the major coastal ranges of the United States, pioneered intermodal carriage of goods by containers, and now carries more than 600,000 container loads of cargo each year to and from U.S. ports.

Sealand's success is due in large part to American technology, and particularly to the know-how and skills of key American personnel stationed in overseas posts. The specialized nature and advance technology of the containership industry required that key managerial personnel be skilled in Sealand's systems and methods.

No. 2, Del Monte Corp., a major processor and distributor of fruits and vegetables, utilizes 46 domestic and 23 foreign plants in distributing more than 250 varieties of canned, frozen and snack foods in over 60 countries.

No. 3, R. J. Reynolds Tobacco International, an international affiliate of R. J. Reynolds Tobacco Co., supervises manufacturing by foreign subsidiaries and licensees in overseas marketing and distributing of company products in more than 140 countries and territories outside the United States. This requires maintaining a cadre of highly experienced manufacturing, marketing, financial, and other management personnel.

Reynolds' policy is to equalize income and living conditions of its employees whether they are located in the United States or abroad. To assure that equality of compensation between domestic and foreign service employees is maintained, Reynolds incurs additional costs with respect to expatriates by reimbursing them for certain additional costs of living attributable to overseas assignments, as well as for income and social taxes imposed on their salaries and allowance by most foreign governments.

These reimbursements for cost and taxes are then included in the employees' compensation subject to tax under United States and most foreign country tax laws mitigated somewhat by the U.S. foreign tax credit permitted on the expatriate's U.S. income tax return.

Reynolds further reimburses its expatriates for additional U.S. income tax arising from including the initial reimbursement as compensation. This reimbursement then becomes income subject to tax in the U.S., and most foreign countries, resulting in a pyramiding of tax assessed on tax. The effect of Reynolds' equalization policy on the present tax law is that of increasing the cost of placing an expatriate employee overseas from two to three times the cost of the same employee within the United States

Senator **Chafee**. That is a very important figure. You say that to keep an employee overseas at $30,000, when his commensurate salary back here would be $30,000, was two to three times. So you are talking of $60,000 to $90,000?

Mr Sink. It is two to three times depending on the country where he is located.

Senator **Chafee**. That is not all because of this pyramiding of tax?

Mr. **Sink**. No; that is tied up with the entire package of allowances, the pyramiding tax, the entire group of expenditures made for that individual which are set out as some examples that we have in the testimony.

Senator **Chafee**. I see.

Mr. SINK. The present tax laws do not encourage U.S. companies to explore and establish new ventures in foreign countries, ventures which could open up new opportunities in the United States, as well as provide vital overseas training and career development opportunities for U.S. citizens.

Employers from other countries, not hampered by home country restricted taxation of expatriates, are more able to utilize headquarters personnel to search out and develop new opportunities in international trade.

We urge the committee to assist the worldwide competitiveness of the American economy to retain a strong and competitive position in world marketplaces by adopting legislation, which will result in a lower and more equitable tax burden on those Americans working in foreign countries. We support S. 2283 as a minimum to accomplish this result.

Again, we thank you for your interest in this matter which is of great concern to American business in general, and R. J. Reynolds Industries in particular.

Senator CHAFEE. Thank you, Mr. Sink.

Mr. Satterwhite of Enserch Corp.

STATEMENT OF WILLIAM T. SATTERWHITE, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, ENSERCH CORP.

Mr. SATTERWHITE. Senator, my name is William T. Satterwhite. I am senior vice president and general counsel of Enserch Corp.

Enserch Corp. is a diversified energy company engaged in domestic and international activities with about 2,000 employees living and working abroad. We are concerned about the impact of the present tax laws on the income earned by Americans living abroad. We believe that present laws have had a substantial negative effect on our ability to do business overseas, and in particular on our ability to utilize the skills and services of American citizens overseas. We would like to present some examples.

Through a subsidiary, we are an overseas distributor of oil field equipment. Prior to the enactment of the Tax Reform Act of 1976, there were 71 people working in this effort around the world, 12 were Americans. Now, we have 264 people working overseas, 11 of them are Americans.

Senator CHAFEE. Would you say that this is because of this tax policy?

Mr. SATTERWHITE. By and large, that is correct, Senator.

Until recently the company was engaged exclusively in the sale of goods manufactured in this country. However, we now also distribute foreign made products.

The company has four district managers operating in connection with this activity. Because of the tax differential, all four of these people are third country nationals.

A subordinate of one of them, a French national who replaced an American 2 years ago, is stationed in Abu Dabi. For sometime he has been reporting from the field that it would be highly desirable to take on additional lines of products, one not surprisingly manufactured in his own country of France.

Similarly we now sell turbines manufactured by a Norwegian company. We used to sell turbines made by an American company.

The change was brought about directly by the decisions of some of our non-U.S. employees.

We also provide technical and administrative personnel on a contract basis for various types of energy enterprises.

In November 1979, we were renegotiating a service contract with Aramco in Saudi Arabia. At Aramco's request, because of a generally high level of American expertise in a number of areas of the petroleum business, we were asked to utilize U.S. personnel.

When we presented the Aramco negotiators figures showing the cost to the project of U.S. labor, they requested that we return with cost projections for non-U.S. citizens. Today, there are 62 contract personnel on that job, 60 United Kingdom nationals, 1 Pakistani, and 1 Saudi.

On another project we are providing key personnel in Spain, and one of the people provided is an assistant to the client's purchasing representative. He is a foreign national, and in his job places orders for a variety of parts and components necessary for construction of an offshore drilling platform. Not only were American jobs lost, but a key job, that of purchasing agent, went to a foreign national.

At another location in Mexico, we are acting as architect/engineers constructing a powerplant. We are working pursuant to a contract that was entered into in April of 1975. The project is expected to be completed in 1984. Here we are encountering many problems. Some of our employees are housed onsite in camps, while others are not because housing available within the camp is limited.

As a result, two workers standing side by side on the same project, doing identical work, are treated by present tax laws quite differently. We have 38 U.S. citizens working on the project away from the camp, and if we wish to keep them there it will cost an average of approximately $14,000 a year per employee more than it would to employ a third country national.

We must consider recommending to our client that the Americans be replaced by non-American workers when those job contracts expire.

At this point I would like to repudiate the frequently cited myth associated with the present law that American employers are not hindered in host countries which themselves impose substantial income tax burdens.

Some of the high tax countries exempt income derived from high technology occupations. A classic example of this situation is the Arab Republic of Egypt, which under statutory provisions, exempts income derived from various high technology occupations. Thus, an engineer working on a project in Egypt who would otherwise be eligible for various foreign tax credits on his American income tax does not generate such tax credits.

Because of this, nearly all third country nationals have a net pay that is close to the employer gross costs. Yet, American personnel gross costs are 30 to 50 percent higher than their net.

As an international organization, we constantly must look for ways to maximize continuity within our management structure. The optimal way to do is in most situations is to promote from within. That requires us to move people from place to place, and country to country. Under present tax law that is essentially impossible.

As you can see the current tax structure has had a marked impact on Enserch Corp.'s operations. Without legislative relief, the situation can only deteriorate not only for us but for many other businesses similarly affected.

Senator, I sincerely appreciate the opportunity to share with you our concerns and experience in this area. Thank you.

Senator CHAFEE. I think that this is very interesting, particularly the specifics which are always useful and which reinforce the points that have been made throughout the day.

Gentlemen, we thank you very much for coming. I am sorry you had to wait.

[The prepared statements of the preceding panel follow:]

STATEMENT OF
JOHN B. HENDERSON,
TEXTRON INC.
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE
SENATE COMMITTEE ON FINANCE
JUNE 26, 1980

Thank you, Mr. Chairman, I am John B. Henderson, Senior Vice President of Textron Inc., a diversified manufacturing company headquartered in Providence, Rhode Island. I am in charge of Textron's Washington Office. Textron has 64,000 employees in this country and around the world. Our 1979 sales totalled $3.4 billion, twenty-seven percent of which was generated by exports or by the sale of goods manufactured overseas.

Both S. 2418, introduced by Senator Bentsen, and S. 2283, introduced by Senator Chafee, deal with an issue of increasing concern to the United States. In the immediate post-World War II era, we were preeminent, both economically and technologically. During that period, we helped Western Europe, Japan and other nations get on their feet after the devastation of the war. During the same period, the USSR and other Eastern Block nations also developed their technological capacities, and more recently have become serious competitors in certain market areas.

Yet current tax law in this country, as it relates to the ability of American firms to compete effectively overseas, does not reflect an understanding that the post-war era is over. Sections 911 and 913 of the Internal Revenue Code are prime examples of laws which act as major disincentives to effective U.S. competition overseas.

These laws are still a reaction to the days when a few movie stars made millions overseas and paid no U.S. income tax. They neither focus on nor deal effectively with the problems faced by U.S. firms seeking to compete today for major contracts abroad, especially in areas such as the Middle East. Such contracts, whether involving construction work, co-production ventures or otherwise, frequently require large numbers of highly skilled managerial employees. In recent years inflation has made current tax exemptions for these employees all but meaningless in the international environment.

The bills introduced by Senators Bentsen and Chafee would do a great deal to remedy the particular problems caused by Sections 911 and 913, and I would like to speak in favor of both these bills today.

As you know, Section 911 gives a U.S. citizen employed overseas a maximum $20,000 exclusion from Federal income taxes for income earned abroad if he meets the foreign residency requirements fixed by the statute. Section 913 provides deductions for cost of living differentials, as well as for housing, school and transportation allowances. It also provides an additional $5000 for employees in hardship areas. While these sections represent slight improvements over the 1976 tax law, they are still far too restrictive to make overseas employment attractive or even feasible for many employees of American companies.

As the President's Export Council has reported, most of our foreign trading competitors, such as England, France and Germany, can offer their talented citizens jobs in such areas at reasonable salaries, which reflect the fact they they will not be taxed at home on the income earned while they are working abroad. In fact, France and Germany have liberalized their tax policies fairly recently in this regard to encourage employees to accept overseas work. In order to attract equally qualified Americans when bidding on jobs abroad, an American firm has to offer a comparable salary package, plus an additional amount to reflect U.S. taxes which will be paid by the U.S. employees involved. The net effect is that the American firm frequently cannot bid on the job competitively, with the result that it goes to a foreign trading competitor. This is often solely due to the deterrent effect of our tax system, rather than a result of superior ability on the part of the foreign competing firm.

The long-term effects of these tax laws are pernicious. Our companies lose the opportunity to earn money overseas and repatriate it to this country. More important, as our place in the competitive arena weakens, the number of Americans we are able to train and qualify for the complex jobs involved in such overseas work decreases. This further decreases our competitive position and makes us less capable of bidding on future contracts. It damages, therefore, not only our current balance of payments, but our future ability to compete.

The impact of this reduced position goes far beyond the obvious loss to the company involved. When third-party nationals replace Americans in overseas jobs, they tend to order related project equipment manufactured in their own countries, rather than U.S. products. A recent study by Chase Econometrics indicates that the resulting drop in real U.S. exports amounts to about 5 percent. And I understand that a 1978 report by the General Accounting Office equated this to a loss in overseas sales of at least $6 to $7 billion dollars!

As U.S. citizens return from jobs abroad, unemployment in this country also increases. We are, in effect, adding to the domestic work force, without increasing the number of domestic jobs.

Where workers do remain abroad, higher costs which companies must pay to keep them there add significantly to inflation in this country. The Chase survey indicates that these costs, as they are passed along, add anywhere from two to ten percent to the cost of U.S. goods and services, depending on the industry involved.

As I mentioned, many of the industrial nations which constitute our major foreign trading competitors provide no limit on the amount which their employees can earn overseas, free of taxation in their home countries. While a good case can be made for this approach, it could be, at least theoretically, susceptible to abuse. We, therefore, fully support the legislative approach taken in both Senator Chafee's and Senator Bentsen's bills, which place a reasonable limit on the amount which can be earned overseas free of U.S. taxation. In the opinion of our Division Companies which do business overseas, the limits established in each of those bills are generally adequate to permit us to compete on a substantially equal footing with our major foreign trading competitors.

Textron strongly urges this Subcommittee to report favorably to the Committee on Finance a bill incorporating exemptions from U.S. taxation for U.S. employees serving overseas similar to those contained in S. 2418 and S. 2283.

In addition, based on a special experience of our Bell Helicopter Textron Division, I would like to invite the attention of the Subcommittee to Section 1 (A)(3) of Senator Bentsen's bill, S. 2418. This section deals with the situation in which U.S. employees are forced out of a foreign country by events over which neither the company nor employees have any control.

In 1978, Bell Helicopter Textron was engaged in the performance of a series of contracts with the government of Iran. One of these contracts involved training Iranian personnel in the servicing and operation of Bell Helicopters which had been purchased by the government of Iran. Another contract, involved co-production by Iran and Bell of particular Bell Helicopter models, within Iran. At the time of the Revolution, Bell had approximately 3900 employees in Iran. When the Revolution occurred, and all of these employees were forced out of Iran, more than 2000 failed to qualify for tax exemptions under the residence requirement imposed by current law.

Bell Helicopter and its employees meticulously followed the advice of the State Department on the timing of the departures from Iran. In fact, we stayed at the urging of the State Department, considerably longer than most felt was safe under the circumstances. When we left, it was solely because the situation in Iran had become chaotic and because we were instructed by the State Department to leave. It therefore strikes us that, under any reasonable standard of equity, our employees who were forced out of Iran by conditions outside of their control, and the employees of other companies who left under similar circumstances should not be denied existing exemptions from U.S. tax.

I am aware that this Subcommittee has previously approved tax relief for U.S. employees forced to return to this country by events outside of their control. On December 6, 1979, a measure to accomplish this, S. 873, was approved by the full Finance Committee. Comparable legislation was previously approved by the House Ways and Means Committee and passed by the House on December 17.

I recognize that there are some procedural problems involved, due to the fact that the House bill, H.R. 5973, contains provisions covering several other special tax issues, not all of which have been fully considered by the Finance Committee. However, the question involved is far too important, and its potential impact on employees of U.S. firms is too great to let it go unresolved. I urgently ask your assistance in seeing this matter through the Senate this year, both in the form of S. 873, and as part of the broader measure on Sections 911 and 913 which I hope your Committee will report.

Your actions on taxation of American employees overseas will have a substantial impact on this country's inflation, unemployment and balance of trade in the years to come.

Mr. Chairman and Members of the Committee, I thank you for the opportunity to appear before you today. I will be happy to answer any questions you may have.

SUMMARY OF PRINCIPAL POINTS
STATEMENT OF R. J. REYNOLDS INDUSTRIES, INC.
TO THE SENATE FINANCE COMMITTEE
(SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY)
REGARDING SECTIONS 911 AND 913 OF THE INTERNAL REVENUE CODE
JUNE 26, 1980

R. J. Reynolds Industries, Inc., ("Reynolds"), with combined 1979 sales and revenue of $8.9 billion, 114,280 stockholders, 79,487 employees, doing business in more than 140 countries and territories outside the U. S., considers ability to thrive and compete internationally directly related to placement of competent U. S. employees in our operations abroad. These employees have greater tax burdens than employees of other nations, and Reynolds pays the difference between its employees' tax burdens as expatriates and their tax burdens as U. S. based employees.

Reynolds' operating company subsidiaries include three with very substantial foreign operations:

(1) Sea-Land Service, Inc., ("Sea-Land"), an ocean common carrier, serves more than 122 ports in over 45 countries, serves the major coastal ranges of the U. S., pioneered intermodal carriage of goods by containers, and now carries more than 600,000 container loads of cargo each year to and from U. S. ports. Sea-Land's success is due in large part to American technology and particularly to the know-how and skills of key American personnel stationed in overseas posts. The specialized nature and advanced technology

of the containership industry require that key managerial personnel be skilled in Sea-Land's systems and methods. Sea-Land presently has 92 U. S. citizens in overseas positions in 19 countries.

(2) Del Monte Corporation, ("Del Monte"), a major processor and distributor of fruits and vegetables, utilizes 46 domestic and 23 foreign plants in distributing more than 250 varieties of canned, fresh, frozen, and snack foods in over 60 countries. Del Monte presently employs 58 American citizens in 8 countries outside the U. S. to assist and train foreign nationals in its management techniques.

(3) R. J. Reynolds Tobacco International, Inc., ("Tobacco' International"), an international affiliate of R. J. Reynolds Tobacco Company, supervises manufacturing by foreign subsidiaries and licensees and oversees marketing and distribution of company tobacco products in more than 140 countries and territories outside the U. S. This requires maintaining a cadre of highly experienced manufacturing, marketing, financial, and other management personnel. There are presently 55 American citizens working in 15 countries engaged in these activities for Tobacco International.

Reynolds' policy is to equalize income and living conditions of its employees whether they are located in the U. S. or abroad. To ensure that equality of compensation between domestic and foreign service employees is maintained, Reynolds incurs additional cost with respect to expatriates by reimbursing them for certain additional costs of living attributable to overseas assignments as well as for income and social taxes imposed on their salaries and allowances by most foreign countries. These reimbursements of costs and taxes are then included in employees' compensation subject to tax under U. S. and most foreign country tax laws, mitigated somewhat by the U. S. foreign tax credit permitted on the expatriates' U. S. income tax returns. Reynolds further reimburses its expatriates for additional U. S. income tax arising from including the initial reimbursement as compensation. This reimbursement then becomes income subject to tax in the U. S. and most foreign countries resulting in a pyramiding of tax assessed on tax.

Examples comparing the tax cost of a U. S. expatriate under the tax law prior to 1976, the "Tax Reform Act of 1976" and the "Foreign Earned Income Act of 1978" generally show the tax costs of the latter to be less than under the "Tax Reform Act of 1976" but greater than they would have been prior to 1976.

The effect of Reynolds' equalization policy under present tax law is that of increasing the cost of placing an expatriate employee overseas from two to three times the cost of the same employee within the U. S. The expatriate employee, however, has received no net economic benefit by virtue of this overseas assignment.

Present tax laws do not encourage U. S. companies to explore and establish new ventures in foreign countries - ventures which could open up new opportunities in the U. S. as well as provide vital overseas training and career development opportunities for U. S. citizens. Employers from other countries, not hampered by home country restrictive taxation of expatriates, are more able to use headquarters personnel to search out and develop new opportunities in international trade.

We urge the Committee to assist the worldwide competitiveness of the American economy to retain a strong and competitive position in world market places by adopting legislation which will result in a lower and more equitable tax burden on those Americans working in foreign countries. We support S.2283 as a minimum to accomplish this result.

STATEMENT OF

R. J. REYNOLDS INDUSTRIES, INC.

TO THE

SENATE FINANCE COMMITTEE

(SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY)

REGARDING

SECTIONS 911 and 913 OF THE INTERNAL REVENUE CODE

JUNE 26, 1980

This statement sets forth the views of R. J. Reynolds Industries, Inc., ("Reynolds"), in connection with your consideration of S.2283, S.2321, and S.2418, which bills would alleviate the tax burden of United States citizens living and working abroad ("expatriates").

Reynolds, a Delaware corporation with its principal place of business located on Reynolds Boulevard, Winston-Salem, North Carolina, had combined sales and revenue in 1979 of $8,935,200,000, 114,280 stockholders, and 79,487 employees. We do business in more than 140 other countries and territories. Our ability to thrive as a U.S. company, provide U.S. employment and compete internationally is based upon our ability to place a selected number of competent U.S. employees in our operations abroad. Our employee's willingness and ability to accept foreign employment requires us to pay the difference between an individual's tax burden as an expatriate and the tax burden as a U.S. based employee. This increased cost reduces our competitiveness with foreign companies because citizens of other nations generally do not have the same home country tax costs as U.S. expatriates.

Included among Reynolds' operating company subsidiaries are three with very substantial foreign operations:

(1) Sea-Land Service, Inc., ("Sea-Land") is a Delaware corporation with its headquarters in Edison, New Jersey. Sea-Land is an ocean common carrier serving more than 122 ports in over 45 countries. It operates U.S.-Flag vessels in the United States foreign commerce and serves the major coastal ranges of the United States. In 1979 Sea-Land's revenues amounted to $1,220,400,000. Sea-Land pioneered the intermodal carriage of goods by container and now carries more than 600,000 container loads of cargo each year to and from U.S. ports.

Sea-Land is the world leader in its field and is the largest U.S.-Flag carrier in the American Merchant Marine. Sea-Land's success is due in large part to American technology and particularly to the know-how of key American personnel stationed in overseas posts.

These employees possess unique skills developed through years of involvement in the industry within the United States.

In the course of carrying out this specialized and complex form of trade, it is desirable for Sea-Land to relocate its skilled American citizens abroad so that the flow of commerce can move in as expeditious a manner as possible. Because of the specialized nature of business in which Sea-Land is engaged, it is of great importance that key managerial personnel in all Sea-Land locations, both at home and abroad, be skilled in Sea-Land's systems and methods.

In view of the advanced level of technology of the containership industry and the special requirements imposed by it in the selection of personnel, the availability of qualified operating personnel overseas is often limited in such managerial areas as equipment maintenance; shore crane maintenance; refrigeration technology; and computerized documentation, space booking parking control and vessel storage. Therefore, U.S. citizens need to be expatriated to fill these jobs and to train foreign nationals in these and many other fields. At the present time Sea-Land has 92 U.S. citizens in overseas positions in 19 countries.

Sea-Land is presently the world's leader in the containership industry, where it competes with ever-increasing foreign-flag resources. The governments of our chief competitors do not place the same tax burdens on their overseas employees as does the United States. Thus, a foreign-flag vessel operator which competes with Sea-Land in U.S.-foreign commerce and whose personnel are located in the United States does not have to shoulder the same cost burden as does a U.S.-Flag operator.

(2) Del Monte Corporation, ("Del Monte"), is a New York corporation with its headquarters in San Francisco, California. Del Monte, a major processor and distributor of fruits and vegetables, utilizes 46 domestic and 23 foreign plants in distributing more than 250 varieties of canned, fresh, frozen, and snack foods around the world. Outside of the United States, Del Monte has plants in Canada, Mexico, Venezeula, the United Kingdom, Greece, Kenya, South Africa, Italy, and the Philippines with distribution to over 60 countries. With the plants located close to the centers of distribution, the company is able to

react quickly to take advantage of sudden changes in supply and demand within world markets.

Del Monte presently employees 58 American citizens in 8 countries outside of the U.S. to assist and train foreign nationals in its management techniques.

(3) R. J. Reynolds Tobacco Company, ("Tobacco") a New Jersey corporation headquartered in Winston-Salem, North Carolina, is among the world's largest manufacturers and distributors of tobacco products. In 1979, Tobacco with revenues of $5,033,400,000 paid over a billion dollars to the U.S. Treasury for excise and income taxes.

Tobacco, through its international affiliate, R. J. Reynolds Tobacco International, Inc., ("Tobacco International") supervises the manufacture of its products by foreign subsidiaries and licensees, and oversees marketing and distribution of company tobacco products in more than 140 countries and territories outside the United States. This requires maintaining a cadre of highly experienced manufacturing, marketing, financial, and other management personnel who are well versed in their fields. Tobacco International also finds it necessary to have some of its U.S. citizen employees accept foreign assignments from time to time.

At the present time, Tobacco International has 55 American citizens performing these tasks in 15 countries outside the U.S.

In order to attract and retain competent, qualified employees, the policy of Reynolds is to equalize as much as possible the income and living conditions of all its employees regardless of whether they are located in the United States or abroad. Many of the overseas assignments involve considerable sacrifice in family life to these skilled and experienced employees who are so important from time to time in some foreign operations in the face of ever increasing competition from foreign companies. To induce the workers to take the foreign assignments and to ensure that equality of compensation between our domestic and foreign service employees is maintained, Reynolds incurs additional cost with respect to expatriates by reimbursing them for certain additional costs of living attributable to overseas assignments as well as for income and social taxes imposed on their salaries and allowances by most foreign countries. This reimbursement of costs and tax is then included in the employees' compensation subject to tax under U.S. and most foreign country tax laws, subject to some mitigation by the U.S. foreign tax credit permitted on the expatriates' U.S. individual income tax returns. Reynolds then further reimburses its expatriate employees for the additional U.S. income tax arising from including the initial reimbursement as compensation. This reimbursement then becomes income subject to income tax in the U.S. and most foreign taxing jurisdictions resulting in the phenomenon of a pyramiding of tax assessed on tax.

Although the "Foreign Earned Income Act of 1978" granted limited deductions against income for certain qualified excess foreign living costs, and in most cases reduced the amount of tax liability from that which would have been due under the "Tax Reform Act of 1976," the resultant tax liability is usually greater than it would have been prior to 1976.

Exhibits A, B, and C, attached, compare the tax cost of a U.S. expatriate under the tax law in effect prior to 1976, the "Tax Reform Act of 1976," the "Foreign Earned Income Act of 1978," and proposed Senate bills 2283, 2321, and 2418, for some of the countries in which Reynolds' subsidiaries have U.S. citizen employees. In each example, taxes for a three-year period are presented to illustrate the results of pyramiding tax on tax.

The effect of Reynolds' equalization policy under present tax law is that of increasing the cost of placing an expatriate employee overseas from two to three times the cost of the same employee within the United States. The expatriate employee; however, has received no net economic benefit by virtue of his overseas assignment. In fact, he frequently suffers when he must replace his U.S. residence at greatly inflated price upon his repatriation to the U.S. The significance of this great cost increase is important not only to Reynolds and the long-term health of the United States economy but also to the professional development of U.S. managers.

Because it has become uncompetitive to keep an American in foreign locations more and more U.S. nationals are being denied the opportunities for vital overseas training and career development opportunities - opportunities that are available to the employees of our foreign competitors. In commenting on the tax increases brought about by changes in Section 911 of the Internal Revenue Code, on page 17 of a report to the Congress of the United States issued February 21, 1978, entitled "Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas," the Comptroller General of the United States stated, "Each assumed change in Section 911 will yield a certain dollar amount by which the tax revenue of the Treasury will increase. Each change will also cause export prices to rise by twice the amount of the increase in taxes." It would be logical to assume that the converse would be true - a reduction in the tax cost to expatriate employers would result in a decrease in export prices making American companies more competitive and increase export of American made goods.

The tax laws of the United States do not encourage U.S. companies to deploy Americans overseas to explore and establish new ventures in foreign countries - ventures which could open up new employment opportunities for U.S. citizens in the United States. Employers from other countries, not hampered by home country restrictive taxation of their expatriate employees, are more able to use headquarters personnel to search out and develop new opportunities in international trade.

We strongly urge the Committee to assist the worldwide competitiveness of the American economy to retain a strong and competitive position in world market places by adopting legislation which will result in a lower and more equitable tax burden on those Americans working in foreign countries. We support S.2283 as a minimum. We realize that there could be problems of administration and enforcement if we were to free all U.S. citizens not resident in the U.S. from U.S. taxation of all their foreign earned income. Nevertheless, we suggest that these problems might be substantially alleviated by formulating a statutory standard which would ensure that the U.S. citizen's residence abroad is attributable to a bona fide

business purpose of the individual or his employer. We would be pleased to assist your staff in attempting to formulate such a test.

Reynolds appreciates the opportunity to present this statement to the Committee in its consideration of changes to Sections 911 and 913 of the Internal Revenue Code.

EXHIBIT A

COMPARISON OF THE IMPACT OF U.S. LEGISLATION AND PROPOSED LEGISLATION ON INCOME TAX LIABILITY AND COMPANY EXPENSE FOR AN EXPATRIATE IN HONG KONG EARNING A BASE SALARY OF $40,000

	Year 1	Year 2		Year 3	
Base salary	$40,000	$40,000		$40,000	
Tax Reimbursement (Company Cost)	-	See Year 1*		See Year 2**	
Housing allowance (cost)	20,000	20,000		20,000	
Cost of living allowance	12,000	12,000		12,000	
School for children	5,000	5,000		5,000	
Home leave travel	7,000	7,000		7,000	
	$84,000	$84,000	Plus Tax Reimb.-Year 1	$84,000	Plus Tax Reimb.-Year 2

	U.S. Tax Liability			Total U.S. and Foreign Tax Liability			Net Company Cost After Reduction For U.S. Tax on Base Salary		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3	Year 1*	Year 2**	Year 3
Tax Law Prior to 1976	$ 8,523	$10,605	$11,804	$17,228	$20,808	$22,598	$ 7,260	$10,840	$12,631
1976 Tax Reform Act	18,965	24,630	27,830	27,670	36,568	41,024	17,702	26,600	31,056
Foreign Earned Income Act of 1978	9,719	13,057	13,252	18,424	23,458	26,483	8,458	13,490	16,510
Proposed S.2283 (Chafee)	-0-	-0-	-0-	8,705	8,705	8,705	-0-	-0-	-0-
Proposed S.2321 (Jepsen)	-0-	-0-	-0-	8,705	8,705	8,705	-0-	-0-	-0-
Proposed S.2418 (Bentsen)	-0-	-0-	-0-	8,705	8,705	8,705	-0-	-0-	-0-

Assumptions:

- Married with two children
- Residing in Hong Kong for more than three years (Reynolds largest concentration of expatriates is in Hong Kong)
- For comparability 1979 tax rates, exemptions, and zero bracket amounts are used in each example
- Three years are presented to show the pyramiding effect of tax on tax

EXHIBIT B

COMPARISON OF THE IMPACT OF U.S. LEGISLATION AND PROPOSED LEGISLATION ON INCOME TAX LIABILITY AND COMPANY EXPENSE FOR AN EXPATRIATE IN THE NETHERLANDS EARNING A BASE SALARY OF $40,000

	Year 1	Year 2	Year 3
Base salary	$40,000	$40,000	$40,000
Tax reimbursement (Company cost)	-	See Year 1*	See Year 2**
Housing allowance (cost)	12,000	12,000	12,000
Cost of living allowance	10,000	10,000	10,000
School for children	5,000	5,000	5,000
Home leave travel	6,000	6,000	6,000
	$73,000	$73,000 Plus Tax Reimb.-Year 1	$73,000 Plus Tax Reimb.-Year 2

	U.S. Tax Liability			Total U.S. and Foreign Tax Liability			Net Company Cost After Reduction For U.S. Tax on Base Salary		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3	Year 1*	Year 2**	Year 3
Tax Law Prior to 1976	$ -0-	$ -0-	$-0-	$14,968	$16,785	$17,582	$ 5,000	$ 6,817	$ 7,614
1976 Tax Reform Act	8,129	9,970	10,850	23,097	29,730	33,074	13,129	19,762	23,106
Foreign Earned Income Act of 1978	-0-	-0-	-0-	14,968	16,785	17,582	5,000	6,817	7,614
Proposed S.2283 (Chafee)	-0-	-0-	-0-	14,968	16,785	17,582	5,000	6,817	7,614
Proposed S.2321 (Jepsen)	-0-	-0-	-0-	14,968	16,785	17,582	5,000	6,817	7,614
Proposed S.2418 (Bentsen)	-0-	-0-	-0-	14,968	16,785	17,582	5,000	6,817	7,614

Assumptions:

- Married with two children
- Residing in The Netherlands for more than three years
- For comparability 1979 tax rates, exemptions, and zero bracket amounts are used in each example
- Three years are presented to show the pyramiding effect of tax on tax

EXHIBIT C

COMPARISON OF THE IMPACT OF U.S. LEGISLATION AND PROPOSED LEGISLATION ON INCOME TAX LIABILITY AND COMPANY EXPENSE FOR AN EXPATRIATE IN SAUDI ARABIA EARNING A BASE SALARY OF $40,000

	Year 1	Year 2		Year 3	
Base salary	$ 40,000	$ 40,000		$ 40,000	
Tax reimbursement (Company Cost)	-	See Year 1*		See Year 2 **	
Housing allowance (cost)	40,000	40,000		40,000	
Cost of living allowance	12,000	12,000		12,000	
School for children	15,000	15,000		15,000	
Home leave travel	12,000	12,000		12,000	
Hardship Allowance	12,000	12,000		12,000	
	$131,000	$131,000	Plus Tax Reimb.-Year 1	$131,000	Plus Tax Reimb.-Year 2

	U.S. Tax Liability			Total U.S. and Foreign Tax Liability***			Net Company Cost After Reduction For U.S. Tax on Base Salary		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3	Year 1*	Year 2**	Year 3
Tax law prior to 1976	$ 40,678	$56,028	$63,708	$ 40,678	$56,028	$63,708	$ 30,710	$46,060	$53,740
1976 Tax Reform Act	50,337	70,522	80,614	50,337	70,522	80,614	40,369	60,554	70,646
Foreign Earned Income Act of 1978	19,070	37,360	39,493	19,070	37,360	39,493	9,102	27,392	29,525
Proposed S.2283 (Chafee)	12,032	12,920	13,382	12,032	12,920	13,382	2,064	2,952	3,414
Proposed S.2321 (Jepsen)	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Proposed S.2418 (Bentsen)	7,080	7,080	7,080	7,080	7,080	7,080	-0-	-0-	-0-

***Saudi Arabia does not impose an income tax on individuals

Assumptions:

- Married with two children
- Residing in Saudi Arabia for more than three years
- For comparability 1979 tax rates, exemptions, and zero bracket amounts are used in each example
- Three years are presented to show the pyramiding effect of tax on tax

STATEMENT OF
WILLIAM T. SATTERWHITE
SENIOR VICE PRESIDENT AND GENERAL COUNSEL
ENSERCH CORPORATION
BEFORE
THE SENATE SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

JUNE 26, 1980

Mr. Chairman, and distinguished Members of the Subcommittee, it is a pleasure and a privilege for me to be here with you this afternoon. My name is William T. Satterwhite, and I am Senior Vice President and General Counsel for ENSERCH Corporation, and on behalf of myself and my associates I wish to thank you for your interest in the taxation of American citizens living abroad.

ENSERCH Corporation is a diversified energy company engaged in various domestic and international activities, including:

- exploring for, developing, producing and marketing oil, natural gas, and natural gas liquids;

- providing onshore and offshore petroleum production services as well as products;

- providing specialized engineering, construction and consulting services; and,

- providing integrated natural gas utility service to over 1.1 million customers, principally in the state of Texas.

We are concerned by the impact of present tax laws relative to income earned by Americans living abroad. It is our perception that present laws have had a substantial negative impact on our ability to do business overseas, and in particular on our ability to utilize the skills and services of American citizens overseas.

We understand that other companies similarly situated are encountering the same types of difficulties, but it is not our purpose here today to speak to you about the macro economic implications of present law or the activities of other U.S. taxpayers. Other witnesses here today have touched those subjects quite adequately. My purpose - by contrast - is to provide you with some fairly specific examples of how the present law has affected ENSERCH's ability to compete and our ability to export American made goods and services.

I.

Through a subsidiary we are overseas distributors of oil field equipment. At present all four regional directors of our distribution efforts are non-U.S. citizens. Prior to the enactment of the Tax Reform Act of 1976 there were 71 people working in this effort around the world; 12 were Americans. We now have 264 people working overseas; 11 of them are Americans. Until recently, the company was engaged exclusively in the sale of goods manufactured in this country. However, for a variety of reasons, we now also distribute foreign made products.

The company has four district managers operating in connection with this activity. Because of the tax differential all four of these people are third country nationals. A subordinate of one of these district managers - a French national (who replaced an American two years ago) - is stationed in Abu Dhabi. For some time now he has been reporting from the field that it would be highly desirable to take on an additional line of products, one - not too surprisingly - manufactured in his home country of France.

Similarly, we now sell turbines manufactured by a Norwegian Company - Kongsberg. We used to sell turbines made by an American company - Solar, which is a division of International Harvester. The change was brought about directly by the efforts of some of our non-U.S. employees.

These individuals are responsible for millions of dollars in annual sales of equipment. They are living proof of the proposition that foreign employees favor selling products made in their homeland rather than those made "abroad" in this country. Their employment, as a result of the tax differential, directly and substantially detracts from our national ability to continue to provide American made goods to foreign markets. The situation speaks for itself.

II.

We also provide technical and administrative personnel on a contract basis for various types of energy enterprises. In November, 1979, we were renegotiating a service contract with ARAMCO in Saudi Arabia. At ARAMCO's request (because of a generally higher level of American expertise in a number of areas of the petroleum business) we were asked to utilize U.S. personnel, including welding inspectors, welders, civil and mechanical engineers and an accountant. When we presented the ARAMCO negotiators figures showing the cost to the project of U.S. labor, they requested that we return with cost projections for non-U.S. citizens. Today, there are 62 contract personnel on that job - 60 United Kingdom nationals, one Pakistani, and one Saudi. The cost of using Americans was $10,000 to $12,000 per year higher for each employee, in large measure because of the present tax treatment of U.S. citizens. Thus, there was a cost differential involved of more than $600,000 just on this project. Jobs which would have gone to 62 Americans were lost to foreign competitors.

III.

Similarly, on another project we are providing key personnel in Spain for Chevron. One of the personnel provided is an assistant to the client's purchasing representative; in that capacity he actually places orders for a variety of parts and components necessary for construction of an offshore drilling platform.

We bid on this contract on a competitive basis. The contract was ultimately obtained on a competitive negotiation; all personnel provided were subjects of the United Kingdom. We could not obtain the contract using American workers because of the cost differentials involved.

Not only were American jobs lost, but a key job - that of purchasing agent - went to a foreign national. Human nature being what it is, foreign nationals order foreign made goods. American nationals are more likely to order American made goods. This is particularly true in those situations where there is little or no actual difference in the quality of the product involved but is also true in situations where there may be a superior U.S. product. A foreign national is accustomed to the company name and language used at a home based concern.

IV.

At another location, in Mexico, we are acting as architect/engineer, constructing a power plant. We are working pursuant to a contract which was entered into before the adoption of the Tax Reform Act of 1976. The project will take a number of years to complete.

On this project we are encountering a new kind of problem. As you know, those who are employed abroad and live in "camps" in hardship areas are eligible for the $20,000 exclusion. Similarly situated workers who do not live in "camps" are not eligible for the exclusion but instead get a series of excess living expense deductions. Some of our employees are housed on site in "camps" while others are not because housing available within the "camps" is limited; there are more workers than there are living accommodations.

As a result, two workers standing side by side on the same project doing identical work are treated by present tax laws quite differently. One lives in the camp; the other in a distant town.

As you gentlemen well know, one of the basic tenets of sound tax policy is that individuals who are similarly situated should be taxed in a like manner. I submit to you that the present system simply does not measure up to this standard in this case.

We have 38 United States citizens working on the project away from the camp; and if we wish to keep them there, it will cost an average of approximately ~~$20,000~~ $14,000 a year per employee more than it would to employ third country nationals at that job site. We must consider recommending to our client that the Americans be replaced with non-American workers when those job contracts expire.

V.

Offshore diving and underseas services are also provided by our company. Until the relatively recent past - 1977 or 1978 - the U.S. was preeminent in this area. There was minimal foreign competition, and those who needed these services essentially had to use American workers. Now, however, the United Kingdom, South Africa, Australia and Norway are serious competitors. When one takes into consideration the tax differentials involved, it is not surprising that companies and workers from these countries are now making substantial inroads into this area. This is one more area where we are losing an American market.

VI.

At this point I would like to repudiate a frequently cited myth associated with present law - that Americans are not hindered in host countries which themselves impose substantial income tax burdens. Those with this view see this as the case because the foreign tax credit available to an American taxpayer effectively eliminates the U.S. tax burden. Occasionally, this is so. Perhaps the people down at the Treasury Department who sit and compare tax rates that are written down in dusty books are portraying their assessment of the present situation, but let me tell you what really goes on.

Some of the "high tax" countries exempt from income taxes income derived from "high technology" occupations. In these situations a country that has an otherwise high income tax burden actually imposes no tax on an American citizen living and working there in such occupations. A classic example of this situation is the Arab Republic of Egypt which under statutory provisions (Law 43-74) exempted income derived from various "high technology" occupations. Thus, an engineer working on a project in Egypt who would otherwise be eligible for various foreign tax credits against his American income taxes does not generate such tax credits, because he in fact pays no income tax to Egypt.

More prevalent - and perhaps more interesting - the taxing authorities in many foreign countries simply turn the other way. Their laws do not exempt Americans from paying local taxes. They just don't collect them. It's an overseas version of the underground economy in reverse. American engineers, for example, simply do not file or pay taxes and, therefore, do not generate foreign income tax credits. This does not inspire confidence in either foreign tax structures or our own income tax system.

VII.

We see more and more non-American personnel in higher technology positions around the world. They are well educated and able people. They - like their American counterparts - look to their net after tax pay as their livelihood. On the other hand, employers must consider total payroll costs, including tax burdens essential to produce equal amounts of after tax income. Nearly all third country nationals, because of tax structures, have a net pay that is close to employer gross costs. Yet, American personnel gross costs are 30 to 50 percent higher than their net. The results are obvious.

These differentials are exacerbated when the customer is a foreign state owned or operated utility or company. Such companies frequently negotiate a reduced tax rate or an exemption for employees - especially long term, highly technical personnel. For a non-American firm with non-American personnel (or a U.S. firm with non-American personnel) both local and home country taxes on employees total zero. That is not the case with U.S. personnel.

VIII.

As you can see, the current tax structure has had a marked impact on ENSERCH Corporation's operations. Without legislative relief the situation can only deteriorate, not only for us, but for many other businesses similarly affected. I am sure you will agree that a reduction of our role in the world marketplace is highly undesirable.

With these factors in mind, ENSERCH Corporation is here today to support Senator Jepsen's Bill (S. 2321), which would exclude all income earned abroad from U.S. taxation. We feel that enactment of this proposal would be a giant step forward in encouraging the revitalization of U.S. competition in foreign markets.

We do, however, recognize that there may be constraints which would preclude such a broad exclusion from passage and, therefore, also support the Bills introduced by Senator Bentsen (S. 2418) and Senator Chafee (S. 2283).

I would like to point out that an important factor in your consideration of legislation which would include a dollar limitation - inflation. The Consumer Price Index has increased by 162.8 percent since 1962 when the $20,000 limit on the exclusion was enacted. An equivalent amount in 1980 terms would be $52,560. Similarly, the $25,000 maximum for persons residing in a foreign country for more than three years, enacted in 1964, would have to be increased to $64,075.

These figures clearly indicate the need to increase the maximum limitations at least to $55,000 and $65,000 respectively and to incorporate an automatic annual cost of living adjustment. If an automatic increase is unwise for some reason, then, at a minimum, any legislation which is enacted should increase the exemption, or phase up, by $5,000 per year for each of the next five years.

Senators, I sincerely appreciate the opportunity to share with you our concerns and experience in this area. ENSERCH Corporation is committed to helping this Subcommittee and its Members in any way we can to facilitate enactment of legislation reducing the tax burden in this area. That would mean more jobs for Americans, both directly in foreign markets, and at home through increased purchases by foreign concerns. Any loss of revenue perceived to exist on a static analysis basis will be recovered may times over through increased economic activity.

We would be pleased to answer any questions you might have and to provide any further information which you would find useful.

Thank you.

Senator **Chafee**. Now we have the final hitters, who have been most patient. Mr. Conklin, Cook Electric International, who made a special effort to be here, I understand, Mr. Joseph Volpe from Parsons, Mr. Krumweide from Grove Overseas Corp., Mr. Leonard from Hercules East Group, and Mr. Fisher.

Gentlemen, I hate to give you one more detail, but the buzzer you heard is a vote. So I might as well go over now. I will come right back, and we will finish up. I do appreciate your tolerance in being so patient today, especially those of you who came from some distance.

We will take a 5-minute recess.

[Recess.]

Senator **Chafee**. Again we thank you for your patience. It has been a long day, but it has been very, very helpful to me. I am sure this panel will be also.

Why don't we go in the order that we have you listed here. Mr. Conklin who I understand has had to make changes to get here.

STATEMENT OF ROGER D. CONKLIN, PRESIDENT, COOK ELECTRIC INTERNATIONAL, INC.

Mr. **Conklin**. Thank you, Mr. Chairman.

My name is Roger Conklin, and I live in Miami where I am president of Cook Electric International, an exporter of American made telecommunications equipment. My testimony comes from a background of 11 years of living in Peru and Brazil.

The day the Tax Reform Act of 1976 was signed, I acquired a retroactive tax liability of $8,000 which 1 day earlier I did not have. We had committed our lifetime savings and everything we could squeeze out of current income towards building a house in Rio de Janeiro on a pay as you go basis, and there was no way that I could afford having my income tax doubled from one day to the next.

The Brazilian company that I worked for importing American made telecommunications equipment, in the order of about $5 million a year, could not pay me any more money, and since my salary was paid 100 percent in Brazilian cruzeiros, there was no way that I could legally convert any of my income to U.S. dollars to pay the U.S. tax. Brazilian currency control laws do not permit remittances to foreign governments to pay taxes.

So 3½ years ago, along with my wife and four children, I resigned my job and returned home to start a new career from scratch, leaving behind our $239,000 in savings in an uncompleted house that we were finally able to sell just a few weeks ago, for payment in nonconvertible currency, and at a $57,000 loss.

The 1976 and 1978 legislation brought taxation of Americans abroad pretty much in line with Americans at home, and supposedly there would be significant increases in the tax revenue from Americans abroad. The legislation, however, destroyed the careers of tens of thousands of Americans who are no longer employable abroad, and their income is gone from the overseas tax base.

The only Americans abroad without a tax problem are those in high tax countries where foreign tax credits offset their entire U.S. tax liability. They are able to successfully compete for jobs because, like everyone else in those countries, they pay taxes only where they live. They generate zero tax revenue for the Treasury exactly as if their incomes were completely exempt from U.S. tax.

Americans in countries with lower-than-U.S. taxes are in real trouble because paying U.S. taxes gives them an additional element in their cost of living which nobody else has. They can't compete.

Senator **Chafee**. I lose you on that. You have got to explain that a little more. If somebody is earning $40,000 and if he is in a country that has a high tax, like in England, he would receive a tax credit for what he paid there. Therefore, what they would have to pay the United States would be minimal.

Mr. **Conklin**. That is correct. In the high tax countries they have no problem.

Senator **Chafee**. Now let's take that person who is in a low-tax country. They don't have a high tax; therefore, they pay a tax in the United States. I can see the difference to the U.S. Treasury, but I can't see the difference to the individual. Why is he worse off by not having a tax credit for the foreign tax? In one way or another, it comes out of his hide.

Mr. **Conklin**. Allow me to try to explain. Let's take that $40,000 figure that you mention. Let's suppose that we have an American who has a salary of $40,000 living in a country where there is no income tax. If he is married, it just happens that his U.S. tax on that $40,000, taking the standard deduction, is $9,366. I just happen to have that figure because that happens to be an example that I worked out.

That means that he is only actually going to have $30,634 upon which to live, whereas everybody else who is getting paid $40,000 in that country has $40,000 on which to live. If he gets tax equalization from his employer, which he might if he has an American employer, he is going to have to have $19,370 of tax reimbursement to cover the U.S. tax that he is going to have to pay.

That means that the cost to his employer is not $40,000, like it is for any other non-American. His salary has to be grossed up to $59,370, which is 48 percent more than what any non-American has to receive, in order to have that same net amount of $40,000. Do you get it?

Senator **Chafee**. I get it.

Mr. **Conklin**. In countries with lower than U.S. taxes is where people are having problems because, as I just mentioned, they have difficulty competing, and non-Americans have replaced thousands of Americans. Few can survive economically in these countries, and those few will generate insignificant amounts of tax revenue.

I ask this question, as I asked myself as Mr. Lubick was speaking: Why are we perfectly content that Americans in high tax countries pay no U.S. tax, but insist that those in low tax countries must do so?

In my opinion, and I say this with all due respect, I think that in the past Congress has attempted to solve the wrong problem. Instead of attaining tax equity between Americans abroad and Americans at home, we need to make taxation of Americans abroad equitable with other nationalities abroad—this has been brought out in numerous testimonies today—so that we can sell our goods and services in the countries that we buy our imports from.

It was not to escape taxes that I moved to Peru 14 years ago. In fact, Peruvian taxes were higher. New Yorkers are not fleeing to Wyoming where the State and local taxes are less than one-fifth of what they are in New York State.

In my written statement, which I hope you will have an opportunity and time to read, I show what would happen if one of our 50 States were to follow the precedent established by the Federal Government, and tax everyone born in that State, no matter where they live. It dramatically illustrates why Americans abroad are in trouble.

There is one additional serious problem. I received a letter a few days ago from the Director of International Operations of the IRS confirming to me that there are thousands of Americans in controlled currency countries who cannot legally obtain dollars to pay their taxes.

It is ironic that on the one hand we enact a Foreign Corrupt Practices Act, while on the other we have a tax law which thousands can only comply with by violating foreign currency control laws. Some countries punish currency violators with the same vigor as drug smugglers.

Senator CHAFEE. I will have to look into that. Somehow that sounds impossible. You mean to say that you have earnings abroad and that you cannot remit them at home to pay your tax?

Mr. CONKLIN. That is absolutely correct. There is a provision in the tax law that allows for blocked currency income, but it is a provision that is completely unworkable because it says, "If you spend your blocked currency income for personal expenditures," that is, food, housing, transportation, and so forth, that it is immediately taxable and the tax is payable in dollars.

This fact has been brought out in previous testimony in the House Ways and Means Committee hearings 2 years ago. This was brought out by several people, but it is a problem that continues to be unaddressed.

Let me say also that it is an area where I have been exchanging correspondence with the Treasury Department for nearly 18 months, and it is only because I have insisted through the White House that they answer my letters that have finally gotten correspondence that gives me a real picture of what the situation is, and that is it.

Senator CHAFEE. I don't want to be too tough on you because you have come a long way, but we have got these other gentlemen here who have been very patient.

What is the country that has the blocked currency that you cannot use it to pay your income tax?

Mr. CONKLIN. It is Brazil, but approximately 80 percent of the countries of the world have some sort of exchange controls. Jamaica in the western hemisphere, along with Colombia, Guyana, and dozens of others.

This is all I have to say. Thank you very much.

Senator CHAFEE. How is your business doing?

Mr. CONKLIN. Our business is doing very well. I changed companies, and I am certainly not going to go back to where I was before. I have no intention of moving overseas. I am quite happy with what I am doing now. But I really took a bath, and I hope that whatever you do, you straighten things out so that this does not continue to happen to others.

Senator **Chafee**. Thank you.

Mr. Volpe.

STATEMENT OF JOSEPH VOLPE, VICE PRESIDENT, RALPH M. PARSONS CO.

Mr. **Volpe**. Mr. Chairman, I am a senior vice president of the Parsons Corp., a corporation that does engineering/construction throughout the world. We employ approximately 12,000. We work in Algeria, the Philippines, India, Egypt, Saudi Arabia, Abu Dabi, Kuwait, and Latin America. We are having severe problems with the tax laws as presently written and the IRS regulations now in effect.

I would ask the chairman if I could have the statement which I have submitted to the committee extended in full in the record as though read, but I don't want to take that much time because I know the afternoon has been long. I just want to make a very few comments.

Senator **Chafee**. Your statement will be placed in the record. Please give more of a personal experience or of your company, and how this has affected you. You are pulling people back and not sending them abroad because of this. That reinforces our case.

Mr. **Volpe**. Let me give a few examples.

But before I do I would like to make a couple of comments on some of the things said by Mr. Lubick.

For example, he said that there is no proof that the selection of a U.S. engineer constructor, let us say, in Saudi Arabia would necessarily mean that that would bring home an export of equipment and materials.

I don't think Mr. Lubick really understands the business because if Saudi Arabia selects Parsons to design and construct a gas plant, or a refinery, or a chemical plant, they selected an American firm, American know-how, American technology, and U.S. equipment and materials.

He also said it was not clear that if the Japanese or some other foreign contractor was selected that that would exclude exports from the United States. Again, I think Mr. Lubick does not understand the industry. If the Japanese are selected, the equipment and materials are going to come from Japan. If the contractor is German, then the plant is going to come from Germany.

On this matter of whether or not we are losing employees overseas, I would invite Mr. Lubick or any of his representatives to visit our headquarters in Pasadena. We would be happy to have him review our personnel records that show very clearly we not only have people returning from those projects because of the uncertainties of their tax obligation, but we are having one heck of a time inducing people to fill these positions. We have vacancies at the Yanbu project in Saudi Arabia which today are extremely serious.

Speaking of Yanbu, I would like to provide a few figures. The Saudi Government set up what they call the Saudi Arabian Royal Commission for Jubail and Yanbu. They have planned two large industrial complexes. One on the east coast of Saudi Arabia; the other on the west coast.

Yanbu is on the Red Sea. Before this program was estabiished, Yanbu was simply desert. Today it is blossoming into a new industrial area. One of our subsidiaries, the Ralph M. Parsons Co., is the program manager, and was selected for that job some years ago. We have roughly 600 people on that job, and maintaining a full staff there is almost impossible.

Senator CHAFEE. A staffing of Americans?

Mr. VOLPE. Yes, a staffing of Americans.

Senator CHAFEE. Why do you have Americans?

Mr. VOLPE. We have Americans because that is what the Saudi Arabians thought they were getting from the Ralph Parsons Co. Our experience, our expertise, our know-how. To get the engineers and the professionals needed for such positions, we have to provide them with an incentive, otherwise they will not go to Yanbu; they will not go to Abu Dabi, nor some of the other places where we have projects.

Let me give you some figures. Recently we got a breakdown from the Saudi Royal Commission on contracts they awarded for work at Yanbu during the period May 1979 through May 1980. The firms of 14 countries were recipients of work at Yanbu. U.S. firms ranked eighth in that grouping of 14. Japan outdistanced all of them with approximately $155 million in contracts. Korea was next with $80 million, roughly, in contracts. Switzerland captured $89 million. Taiwan, Greece, and the United Kingdom were ahead of the U.S. firms, and the U.S. firms capture approximately $31 million.

We know, and as I said before we will be happy to provide Mr. Lubick, or his colleagues, with all the records we have in our personnel files in Pasadena to demonstrate how serious this personnel problem is.

Senator CHAFEE. Do you think that if we changed the law it would make a difference?

Mr. VOLPE. It certainly will. The 1978 law and the IRS regulations have actually made the matter worse because our people do not know what their tax obligation is going to be.

Mr. Lubick can say that they are now reviewing these returns, but no one knows how long that review is going to take. No one knows what the disallowances are going to be. No one knows what is going to be involved in terms of any contest over their interpretation versus the employee's interpretation of what the rule or regulations say.

Senator CHAFEE. They are so complicated?

Mr. VOLPE. They are so complicated. It is terribly urgent. We have really severe personnel problems because of it.

Senator CHAFEE. Well, you have been a very good witness, Mr. Volpe. I appreciate your coming all this distance. Did you come all the way from Pasadena?

Mr. VOLPE. No. I happen to be here in Washington.

I thank you for the opportunity to appear.

Senator CHAFEE. Mr. Krumweide.

STATEMENT OF NEIL W. KRUMWEIDE, PRESIDENT, GROVE OVERSEAS CORP.

Mr. **Krumweide**. Mr. Chairman, my name is Neil Krumweide. I am president of the Grove Overseas Corp. of Vienna, Va. I happen to be one very close to home.

Senator **Chafee**. We only give you 3 minutes. [Laughter.]

Mr. **Krumweide**. I am also a member of the International Construction Committee of the Associated General Contractors of America. My firm has been active in the international construction market for over 30 years. We have undertaken and completed projects in numerous foreign countries.

I personally lived and worked on many of these jobs during my 20 years of experience abroad. I am accompanied here today by Mr. George E. Stockton, director of the AGC's International Construction Division.

Mr. Chairman, we appreciate the opportunity to appear here today on behalf of AGC, and share with you our concerns on the U.S. tax policies affecting the earned income of U.S. citizens working abroad.

We have divided our statement into three sections. The first dealing with the competitive impact of the current law in our industry and our Nation's overall trade performance. The second, with the conflicting nature of these tax policies with other national priorities in the trade and nontrade areas. Finally, a section dealing with the political and economic realities of securing this greatly needed tax relief.

First, the competitive impact of the sections 911 and 913 taxation. In light of the extensive testimony presented here today on the subject of the macrotrade impacts of the current law, I will refrain from commenting on these aspects.

However, I would like to offer the AGC's endorsement of these arguments, as well as our unqualified support for these efforts, and ask that my written statement and the AGC tax study, which is included partly in that statement, be accepted for the record.

Second, sections 911 and 913 tax policies and competing U.S. policy objectives. There is increasing evidence that a sustained presence by the U.S. engineering and construction industry overseas is in the direct interest of the United States, not only from a trade policy standpoint, but also from a foreign policy and national security perspective.

The United States is now planning to build U.S. military facilities in the Indian Ocean region to accommodate the rapid deployment force in the Middle East at a cost to the taxpayers of approximately $500 million. The U.S. Army Corps of Engineers and the U.S. Naval Facilities Engineering Command will serve as the contracting officer for the construction.

Both the corps and NFEC originally intended to allow foreign contractors to compete for the construction of these bases. A primary reason for this decision was the relative, noncompetitiveness of the U.S. construction industry in this region.

This decision would have virtually precluded the participation of U.S. firms in the construction of our own sensitive military facilities overseas, and would have eliminated the return of the employment, tax, and trade benefits associated with the expenditure to the U.S. economy.

Following testimony by the AGC, and organized labor before the House and Senate Military Construction Subcommittees, report language was included in the appropriations bill which will limit the construction of these bases in certain cases to U.S. firms employing U.S. taxpayers.

The committees recognized that these conditions may increase the cost of construction. However, they stated in their respective report, "Overreliance on foreign source procurement could also jeopardize the ability to mobilize U.S. construction capability in time of crisis."

Without a presence by U.S. firms in the overseas markets, the United States cannot respond to the world's changing strategic balance of power. No other single issue has done more to erode this presence than sections 911 and 913 taxation.

Senator **Chafee**. I have to be kind of tough on you, Mr. Krumweide, because there is another vote on. I just don't want these gentlemen to have to wait through another one. Take another minute.

Mr. **Krumweide**. The same reasoning holds true for foreign assistance programs. The United States makes annual appropriations for foreign assistance in the area of $5 billion. Aside from their development objectives, one of the perceived policy effort benefits of these programs is that they establish a U.S. commercial presence in the borrower countries, opening up new opportunities for trade.

We submit these objectives are not being met due to our relative noncompetitiveness in the international markets. If we are going to contribute our dollars to these programs, it would be our recommendation that we do everything in our power to reap some return on our investment. Again, no single issue has so undermined our competitiveness overseas as that of sections 911 and 913 taxation.

Senator **Chafee**. I will read your statement. I just have to take these other gentlemen because I will be going out.

Mr. Leonard.

STATEMENT OF RICHARD A. LEONARD, PRESIDENT, HERCULES EAST GROUP

Mr. **Leonard**. Mr. Chairman, I am president of Hercules East, a division of Hercules, Inc., of Wilmington, Del. We are a large chemical company with operations in 30 of the States, and 30 countries. I personally have been associated with the export business for 20 years.

We right now have 52 expatriates from the United States overseas, and that is down from about 75 in 1976. A large part of that reduction is due to the tax costs. Last year, we exported just under $300 million worth of goods from the United States, and provided around 3,700 jobs in the United States in our various plants.

In addition to these jobs, our expatriates working on those exports have this ripple effect that others talk about of getting jobs, equipment, products they make, and products from our customers as well.

I have a written statement as well which will cover many of the points that other people have made. It really is absolutely true in our case, this has been raised by others, that we are reducing our people overseas.

Senator **Chafee**. Is it due to this tax cost?

Mr. **Leonard**. It is a cost factor, yes. We are forced to replace them with third nationals. We don't like to do that. The Americans do a better job overseas because they have the attachment and the familiarity with American products.

All that everybody has been detailing to you, we find that is absolutely true also.

Senator **Chafee**. One of the arguments that is used by some people who like to see the United States take up and train foreign nationals is well, if they are not going to be using Americans, they will be using the foreign national. Isn't that good. But it does not work that way, as I understand. They don't take the foreign national but rather choose the third national. It is not the Saudi you hire, but it is the West German, the Swiss, or whoever it might be.

Mr. **Leonard**. That is right.

Senator **Chafee**. Is that what you find, Mr. Volpe?

Mr. **Volpe**. In our case, the professionals, if we start using a lot of Germans and Italians, or British, the client is going to say,

> We did not buy that. We bought United States. We bought your expertise. We bought your technology. If we wanted British, Italian, or German, we would have selected a German company, or an Italian company.

Mr. **Leonard**. We don't have quite that same problem in our business, but still an American is preferred for the reasons of his familiarity with the products, his long association with the business, and strangely enough, regardless of the language capability, language does enter into the difficulties that are always there in communication. They really do.

I have written in several cases, but I would just like to cover one with you very quickly because I think that it is important as an example. It is the case of an American in Japan.

The way we compensate people overseas is that we design the compensation not for increased compensation, but for avoidance of penalty. If you are going to live in the boondocks of Saudi Arabia, you have a different problem, but if you are going to live in Tokyo, or these places, you do compensate to avoid penalty.

That means, you cover housing costs. Tokyo is high. Many of these areas are. These are expenses not income. Therefore, when they are taxed as income, the individual does not have any money to pay them. So the company compensates, and you get into what we call gross up, and it is a pyramiding effect.

So Japan is a good example. There, a $40,000 a year employee, because of these nonincome expense factors which must be paid as income, within 4 years you can be paying as much as a quarter of a million a year for a $40,000 man. It is really a serious problem.

Senator **Chafee**. I guess that is.

Gentlemen, we thank you very much all of you.

This gentleman is Mr. Stockton, and you came with Mr. Krumweide.

Mr. **Krumweide**. Yes. He is the director of the International Construction Committee of the Association of General Contractors.

Senator **Chafee**. Thank you very much for coming. I just want to say that from this testimony, which we have had today and which has been very helpful we will come up with a bill that answers these problems. We have had a lot of good ideas come forward, and I am confident that you are going to see something move in this Senate and, hopefully, in the House as well.

So we are working on it. I hope that you will keep conveying your thoughts to individual members from your States—Senator Cranston, Senator Hayakawa, the Virginia Senators, and so forth. It is very important to let them know that this is an important issue.

Thank you.

Mr. **Krumweide**. Thank you, and we will do all we can to help.

Senator **Chafee**. Good. Thank you.

[The prepared statement of the preceding panel follows:]

FORMAL STATEMENT OF ROGER D. CONKLIN

PRESIDENT, COOK ELECTRIC INTERNATIONAL, INC.

My name is Roger D. Conklin. I am president of Cook Electric International, Inc., Miami, Florida. We export American-made telecommunications equipment to foreign government-owned telephone companies in some 40 plus countries around the world.

Together with my family I lived and worked abroad for 11 years. The first four were in Peru where I was vice-president of the telephone company, and the last 7 were in Brazil where my last position was managing director of a small wholly Brazilian-owned firm selling some $5 million annually of high-technology U. S. imports. The company was prospering and we had decided to stay in Brazil. Rents were astronomical so we bought a lot, hired an architect and started house construction. Long-term mortgages are unknown in Brazil and short-term interest rates at that time were 4% per month, a rate we could not afford, so we invested nearly our entire savings in the construction. My wife went back to teaching. We scraped and saved, cut corners, lived in sub-standard housing and rode public transportation. Every penny we could spare went towards building the house on a pay-as-you-go basis.

The house was still several months from completion when in October 1976 I learned President Ford had signed a new tax law. Eight years before we had been caught in the jaws of a retroactive Peruvian tax law. At that time my salary was $24,750 per year. For two years 45.3% was withheld from every paycheck to meet my retroactive and current Peruvian tax obligations. During those two years we drew on our savings to make ends meet. With the Peruvian experience engraved indelibly in our memories, I quickly obtained a copy of the Tax Reform Act of 1976 and discovered, to my horror, that I had acquired an $8,000 retroactive tax obligation

...2

which I did not have one day before it was enacted, and that this liability would reach nearly $10,000 by the end of the year. This was in addition to the already stiff Brazilian taxation of my world-wide income. My total tax obligation, Brazilian and U.S., had been doubled overnight. With the commitment already made to finish house construction and the $12,000 we were paying to send our four children to the American School in Rio de Janeiro, we were suddenly below the subsistence level. Also, since my salary was paid in Brazilian cruzeiros and not in dollars, there would be no way to legally obtain the dollars required to pay my U.S. tax, even if the money were available, since Brazilian exchange control laws make no provision for remittances to foreign governments to pay taxes on income earned in Brazil. The alternative would be to purchase dollars on the black market. In Brazil this is a felony. Additional compensation from my Brazilian employer to cover this new tax burden, was not available. The choice narrowed down to either renouncing my American citizenship and becoming a naturalized Brazilian, which some of our American friends decided to do, or throwing in the towel and returning home. My employer strongly urged me to become a Brazilian citizen, but after careful consideration we decided to take our lumps financially, keep our citizenship, and return to the States to start life over again from scratch., I was fortunate to find a new job and we arrived in Miami 3 1/2 years ago with little more than some furniture and the clothes on our backs, leaving behind our lifetime savings in a not-yet-completed house in Rio de Janeiro. We bought a house in Miami with a first mortgage, a second mortgage and a borrowed downpayment. Just 5 months ago we were finally able to sell the property in Rio at a $57,000 loss. The downpayment and the yet-to-be collected promissory notes are to be paid in non-convertible currency.

The year following my departure, sales of U.S. imports by my former employer dropped to zero.

...3

A business which spends more for what it buys than it collects for what it sells, is doomed to extinction. Businesses cannot print currency to cover their deficits. A nation which year after year has a chronic trade deficit will, if the trade balance is not restored, find itself with a weakened national currency and rampant inflation. It's the classic problem faced by dozens of lesser developed countries around the world, and the situation of the United States in 1980. There are several causes for our present situation. One of them is the tax philosophy which has made our country the only industrialized nation in the whole world that taxes the earned income of its citizens working abroad. The Tax Reform Act of 1976 was enacted to reduce foreign earned income exclusions and thus produce several hundred million dollars of additional revenue. Unfortunately the Treasury Department calculations gave no consideration to the bahavioral realities of levying additional taxes beyond the ability of individuals to pay. The classic example was the taxpayer interviewed by GAO in 1977 who, with a $40,000 salary was found to have a $50,662 tax. The Foreign Earned Income Act of 1978, which I urged President Carter to veto, was a disappointment. Among other things, it has disrupted the activities of our best and finest representatives abroad; American missionaries and charitable workers, by creating additional tax burdens that such organizations can only meet by cutting back their personnel, programs and activities.

I spend some 40% of my working time abroad where I come in contact with Americans who are subject to American taxes but who do not file returns. Many long-time residents abroad, spouses of foreign nationals and persons with dual citizenship, either don't know, or don't really believe, that the new tax law applies to them. One Brazilian doctor vowed to me that the U.S. government will never get one penny of taxes from his American wife's share of earnings from their community property investments originally made from his hard-earned income. Others in controlled currency countries can't legally obtain dollars to pay U.S. taxes, while some knowingly ignore the law recognizing full well that nothing will happen since they have no

...4

assets in the U.S. for the IRS to seize.

In my opinion the present chaotic situation for Americans abroad exists for one fundamental reason: The seemingly laudable but totally impractical premsie that there should be some sort of equal treatment for all Americans, whether they live at home or abroad. We are trying to solve the wrong problem. The problem which must be solved is how to make taxation of Americans abroad equitable, not with Americans at home but equitable with the taxation of other nationalities abroad. Inequities in our own country exist, and are not that great a problem. According to I.R.S. figures published by Money magazine in 1978, the per capita state and local taxes paid by individuals with adjusted gross incomes in the $35,000 to $50,000 bracket are more than five times as high in New York state as in Wyoming! New Yorkers are not flocking to Wyoming to escape taxes.

Consider what would happen if the Wisconsin legislature were to realize that some Wisconsonites are benefitting from a "flagrant tax loophole" by residing outside of Wisconsin and thereby paying no Wisconsin income tax. To put a stop to this "enormous special privilege", suppose Wisconsin were to start taxing everyone born in that state, regardless of where they now live. Suppose also that Wisconsin tax rates and standard deductions were made identical with our current federal standard deductions and schedules. Everyone living in Wisconsin, no matter where they were born, would be taxed the same, but Wisconsonites living out-of-state would be in real trouble. Being the only state taxing its "citizens by birth", Wisconsonites would have extreme difficulty competing for jobs anywhere else with others taxed only where they live.

If the salary level for a certain job in Florida were $40,000, a Wisconsonite with a spouse, but no children , would have to pay an additional $9,366 in taxes on this $40,000 salary that nobody else from anywhere in the world would have

...5

to pay. This tax calculation is attached. With this Wisconsin tax taken off the top, his $40,000 salary would effectively amount to only $30,634, out of which he would have to pay the same kinds of living expenses and federal, state and local taxes that everyone else in Florida pays. In order to be at the same economic level as others earning $40,000 in Florida, the Wisconsonite would need to have his employer gross up his compensation with a tax equalization payment of $19,370, making his total salary cost to his employer $59,370 for a $40,000 job, or 48% more than needed to employ a non-Wisconsonite.

How many Florida companies, or Wisconsin companies with operations in Florida, could afford to pay Wisconsonites 48% above the going rate? Probably none. Even if an occasional employer could be found who was so much more efficient than his competitors that he could afford a few Wisconsonites and still compete, salary discrimination based on state of origin would probably run afoul of federal anti-discrimination laws. Wisconsonites would be virtually unemployable outside of their home state.

In this hypothetical example, if you replace Wisconsin with the United States, and Florida with almost anywhere else in the world, you will pretty accurately describe the situation created for Americans abroad by our current tax laws. If you are from the United States, you get taxed by two countries. If you are from anywhere else, you pay only the taxes levied by the one country where you live. The net result is that the only foreign countries where Americans are still employable are those where foreign income taxes are equal or greater than the U.S. tax. In those countries the foreign tax credit completely offsets the U.S. tax. They file a U.S. tax return, but the tax due is zero. The U.S. treasury receives no revenue. In those countries where income taxes are non-existent or lower than in the U.S., Americans must also pay additional taxes to the U.S. and, as in the hypothetical example, are unable to compete with other nationalities for jobs in those locations.

...6

The tax revenue generated for the U.S. treasury from those places is not likely to be very significant, because there will be few Americans living and working there. One gets the distinct impression that the purpose of taxing Americans abroad is not to raise revenue, but to punish anyone with the audacity to live in a low tax country.

The other very serious problem, which according to a letter I have received dated May 8, 1980 from the director of international operations of the I.R.S., is a problem for thousands of Americans abroad, relates to the requirement that taxes be paid in U.S. dollars. Tens of thousands of Americans abroad: English teachers, university professors,retired Americans on foreign social security, self-employed, etc. don't work for American companies, and are not paid in dollars. In fact, quite a few employees of American companies are also paid in foreign currency overseas. From what I have been able to determine, currency control regulations of one sort of another are in effect in over 80% of the countries of the world.

I am personally familiar with the situation in only two countries: Peru and Brazil. In 1970, the government of Peru issued a decree prohibiting the possession of foreign currency within the country by permanent residents, including foreigners, and banning foreign bank accounts, assets outside of Peru and salary payments in other than Peruvian currency. Residents were given 30 days to close out their foreign bank accounts and repatriate all their assets from abroad and exchange them for local currency at the Central Bank. Remittances abroad could be made for a very few limited purposes, not including tax payments to foreign governments, through the Central Bank. An acquaintance of mine was apprehended, convicted, sentenced to a long prison term and his assets seized for exchanging local currency for dollars. This decree has since been liberalized, but I understand it is similiar to the laws of some other third world countries where Americans live and work.

...7

In Brazil, currency may only legally be exchanged for foreign currency at banks, for certain approved purposes only, and all remittances abroad must also be made through banks. Again, paying taxes to a foreign government is not one of these approved purposes. I am aware that special applications have been made by Americans to the Central Bank specifically for remittances to pay U.S. taxes to the I.R.S. , but to my knowledge none have ever been approved. Brazil's foreign debt exceeds $50 billion, and their balance of payments deficit for 1979 was $3.21 billion. It is certainly not surprising that the Brazilian government would feel no obligation to further increase their foreign borrowings nor push their balance of payments further in the red in order to provide dollars to Americans resident in Brazil so they could pay taxes to the U.S. government on income earned there. In Jamaica there is a shortage of food and people are going hungry because the central bank has no dollars available for the importation of food, much less for Americans to pay U.S. taxes on Jamaican income. Most governments do not in fact recognize that any other country has a right to levy and collect taxes within their sovereign borders.

The "Blocked Income" section which has appeared in I.R.S. publications ever since I began reading them, and which appears this year in I.R.S. Publication 776 (rev. 1-80) on page 36, is totally unreasonable and unworkable. It says you can defer payment of taxes on blocked income until it becomes unblocked. That seems quite reasonable, but it goes on to explain that income becomes unblocked and the tax due and payable in dollars if you use it for personal expenditures. How spending Brazilian cruzeiros or Cuban pesos on food, clothing, housing or medical expenses is somehow going to make dollars available to pay U.S. taxes is not explained. It has no explanation. It is akin to the medieval speculative philosophy of alchemy, and not something which belongs in a tax law. This problem was mentioned by several during the House Ways and Means Committee hearings which preceeded enactment of the Foreign Earned Income Act of 1978, but the problem remains unaddressed.

...8

How then does the I.R.S. collect taxes from Americans who have no legal means of obtaining dollars? That is a problem left to the U.S. citizen to solve. Many go to the black market. In some countries parallel currency exchange transactions are permitted and take place openly. In other countries it can be dangerous, and if you get caught you can have everything you own confiscated and go to jail for a long time.

If you are very persistent and insist to the I.R.S. that you refuse to violate local laws, you may find out, not from any I.R.S. publication, but perhaps by being informed verbally, that in those countries where there are I.R.S. offices in our embassies or consulates, you might possibly be able to convince the I.R.S. officer that you absolutely have no dollars and he may be willing to exchange exactly the amount of foreign currency needed to fulfill you tax obligation for some of the dollars sent in by the State Department to operate the diplomatic mission. The dollars so exchanged will then be sent out of the foreign country via diplomatic pouch, and your tax obligation will have been paid in dollars as required by U.S. law. The illegal exchange by the taxpayer of blocked currency will have taken place within the walls of a U.S. diplomatic mission where there is no possibility that local police will arrest you for violating currency laws.

In Brazil, remittances abroad in excess of $300 are subject to a 25% income tax which remitting banks are required to withhold. This is a tax on the Brazilian - source income of the foreign recipient of the remittance. Since the transactions of exchanging currency and remitting dollars take place "outside" of the channel prescribed by Brazilian law, the Brazilian 25% withholding tax on Brazilian source income of the I.R.S. is evaded.

There is something fundamentally wrong with a law which obligates thousands of Americans living in dozens of foreign countries to violate the laws of those countries, and which causes an agency of our government to become a party to such violations.

ATTACHMENT

COMPARISON BETWEEN TAX OBLIGATION OF INDIVIDUAL SUBJECT TO HOME STATE (OR COUNTRY) TAXES WHEN LIVING OUT-OF-STATE (OR OUT OF COUNTRY), AND TAX OBLIGATION OF INDIVIDUAL SUBJECT ONLY TO TAXES OF STATE (OR COUNTRY) OF RESIDENCE.

	A NON-WISCONSONITE IN FLORIDA	B WISCONSONITE IN FLORIDA(3)		C WISCONSONITE IN FLORIDA(4)	
SALARY	$40,000	40,000		40,000	
TAX EQUALIZATION	-0-	-0-		19,370	
TOTAL COMPENSATION	40,000	40,000	(5)	59,370	(5)
INCOME TAX	-0-	9,366	(6)	19,370	(7)
NET AFTER TAX INCOME	40,000	30,634		40,000	

NOTES AND ASSUMPTIONS

1. Assumes Wisconsin to be the only state which taxes, at current federal tax rates, everyone born in Wisconsin, regardless of where they now live
2. Assumes Florida has no income tax
3. Wisconsonite in Florid, with no tax equalization compensation from employer
4. Wisconsonite in Florida with sufficient tax equalization compensation from employer to net same after-tax income as any non-Wisconsonite with the same salary living in Florida
5. Total compensation subject tax income tax
6. Income tax on total compensation of $40,000 for married couple filing jointly (2 dependents), standard deduction
7. Income tax on total compensation of $59,370 for married couple filing jointly (2 dependents), standard deduction.

STATEMENT BY
JOSEPH VOLPE, JR.
SENIOR VICE PRESIDENT
THE PARSONS CORPORATION

BEFORE THE
COMMITTEE ON FINANCE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

PUBLIC HEARING ON THE TAXATION OF FOREIGN EARNED INCOME
THURSDAY, JUNE 26, 1980

Gentlemen:

My name is JOSEPH VOLPE, JR. I am a Senior Vice President of The Parsons Corporation. I appreciate the opportunity to appear before your Subcommittee on the matter of foreign earned income taxes.

At a time when Congress and the Administration are seeking answers to many of the problems that plague our economy, it seems particularly timely for this Committee to consider remedial legislation in this area. Other industrial nations use the foreign market places to strengthen and bolster their economies. In our field, we see subsidized contractors and tax free workers competing for the design and construction of facilities to achieve a two-fold objective. It provides work for the contractor and his forces. But more importantly, those projects bring home large orders for equipment and materials. The U.S., on the other hand, by chasing the tax dollars of the American working abroad is sending opportunities for billions in exports which would produce far greater tax dollars and provide increased domestic employment, right down the drain.

The Parsons Corporation companies are service organizations. They provide engineering, procurement, construction, and construction management services in the fields of mining and metallurgy, petro-chemical plants, transportation systems, power plants, airports, and industrial facilities of a wide variety. Parsons is publicly owned, and in 1979, the Corporations' revenues were slightly over $600 million, a substantial part of which came from overseas projects.

Its largest subsidiary, The Ralph M. Parsons Company, has been active on foreign projects for many years in the design, procurement and construction of refineries, gas plants, sulfur plants, and copper plants, to mention a few. The foreign areas and countries worked in have included Africa, India, Indonesia, the Phillipines and the Middle East. Another subsidiary, DeLeuw, Cather & Company, provides engineering and consulting services in the transportation field, and is presently active in Abu Dhabi, Ethiopia, Thailand, Kuwait and Saudi Arabia.

Critical to our success overseas is the availability of experienced engineers and other professionals, at a cost to our clients which is at least comparable to that offered by our foreign competitors. And on this point, it is important to bear in mind that the edge we (U.S. companies) once enjoyed because of our technology and know-how has, as a practical matter, been largely overcome by many of our foreign competitors. Today the cost of our services is the make or break difference on whether we are selected for an assignment.

I have heard some advocates of a higher tax on foreign earned income say "well that's tough, why should people working overseas get a tax break?" I believe the answer is quite simple and straightforward. As a matter of national policy, our tax laws have long recognized that in certain circumstances there is the need for tax restraint for reasons of national or public interest.

I want to be specific by citing a hypothetical situation which is, nevertheless, fairly descriptive of the market place overseas.

A foreign government is planning a large process complex. The estimated cost of that complex may be 2 to 3 billion dollars. That is a choice assignment for Parsons; it would provide significant engineering and other professional services man-months of work. But of equal and perhaps greater significance is the opportunity it provides for U.S. industry to export the equipment and materials required to build such a project. Herein lies the crux of the matter. Certainly we want and need the business, but viewed from a broader perspective there is a greater national interest to be served. The preponderance of cost for such a project is in pressure vessels, compressors, pumps, valves, electrical equipment, bulk materials, and on and on. If such an assignment -- and they are real and almost commonplace in many areas of the world today -- is lost to our foreign competition, those huge orders our industry may have enjoyed are lost, as well.

Many, if not most, projects which fit that description are either underway or in the planning stages in countries and locations where the environment and living conditions are somewhat hostile, to say the least. How do we get the senior engineers and professionals to leave the comforts and amenities they enjoy here for an 18 month or 3 year assignment in such places? As in any hardship or risk situation, the individual is offered a financial incentive. It worked for a long time, and the U.S. enjoyed the fruits of the large projects the American engineer-constructor was able to capture overseas.

When income exclusion legislation was originally enacted, it was called The Foreign Trader Exemption. Congress recognized that it was in the best interest of the country to encourage businessmen and women to live and work abroad to promote American products and services. Today that market is in serious jeopardy for the U.S.

The Ralph M. Parsons Company is the program manager for the Yanbu complex in Saudi Arabia. Yanbu is planned to be a new industrial area near the Red Sea. We were selected several years ago by the Saudi Royal Commission for Jubail and Yanbu. Recently, we received a breakdown on contract awards made by the Royal Commission for the period May 1979 through May 1980. The firms of fourteen countries were recipients of work at Yanbu. U.S. firms ranked 8th in that grouping. Japan outdistanced most with $154,790,580; Korea, $82,836,633; Switzerland captured $89,470,173, and Taiwan, Greece, and the U.K. were ahead of the U.S. firms which received $31,581,595.

Finally, with the Subcommittees permission, I would include for the record the attached letter our Chairman, William E. Leonhard, sent to Secretary Blumenthal, dated January 26, 1977, addressing the consequences we might all expect if tax relief was not forthcoming. Mr. Leonhard, now Chairman and Chief Executive Officer of The Parsons Corporation regrets he could not appear today. I do believe his message to the Secretary of the Treasury puts the tax issue in its proper perspective.

The Ralph M. Parsons Company
ENGINEERS · CONSTRUCTORS / PASADENA, CALIFORNIA 91124

January 26, 1977

COPY

The Honorable W. Michael Blumenthal
Secretary of the Treasury
Washington, D. C. 20220

Dear Secretary Blumenthal:

The Ralph M. Parsons Company, together with other engineer/constructors such as Bechtel, Fluor, Brown and Root, and others, are designing and erecting projects overseas worth billions of dollars. Much of this work is being performed in the Middle East. Numerous other U.S. firms are doing engineering alone or just construction in a number of foreign countries. The vitally important function of the engineering/construction industry in our nation's economic health is all too frequently little understood or appreciated. When the value of equipment and materials purchased in this country for projects handled by U.S. engineer/constructors is added to our engineering and management services, fully 80% of the cost of these projects enters the U.S. economy and contributes substantially to a U.S. balance of payments against our imports, such as Middle East oil.

During the construction phase, a large number of skilled American technicians and specialists are required to work as expatriates in such countries. Unfortunately, certain provisions of the tax bill passed last year threaten to wipe out the use of American expatriates in many countries. The Tax Reform Act of 1976 reduced the earned income exclusion and made other significant changes which severely impact the employment of U.S. personnel overseas. In addition, the tax court has recently ruled that benefits provided in kind are taxable at the highly inflated local market values. These actions have the appearance of rather moderate changes, but their impact on U.S. engineering and construction projects abroad is so severe that I take the liberty of urging your personal attention to this problem.

As a simple example, an average senior expert qualifying for overseas exclusions would, prior to the new law, have had a U.S. income tax liability of about $15,000. Under the new law, his tax liability will be about $30,000. Accordingly, there is little personal incentive for his going overseas unless he is reimbursed for the additional tax burden. Since salaries are usually reimbursable under our contracts, we must ask our foreign clients to pay at least an additional $15,000 per year for a typical U.S. technician. If the construction work is in a country like Saudi Arabia, which does not tax

COPY

The Honorable W. Michael Blumenthal
January 26, 1977
Page two

foreign specialists, and if the expatriate is from any country in Europe or Japan--none of whom tax their expatriates working overseas--then the client must pay a $25,000 per year premium for the U.S. technician, even if the salaries and living allowances are the same. Over the term of a large contract, such added costs will total many millions of dollars.

We cannot reasonably expect our clients to pay such a high premium for U.S. talent. Therefore, the projects will go to European or Japanese contractors and the huge project revenues and related jobs will be lost to U.S. firms. And, ironically, the tax consequences for the U.S. will be just the opposite of what was expected because we will have lost our competitive position and our opportunities for important construction assignments overseas. The Government has not closed a tax loophole--it has slammed the door on U.S. engineering and construction work abroad. Our European and Japanese competitors are incredulous that our nation is voluntarily crippling itself economically in this way, but obviously they are delighted.

The economic well-being of our country is dependent upon the import of billions of U.S. dollars worth of Middle East oil per year. The Arabs, Iranians, and others are quite willing to have us build their refineries and chemical plants. This means we can, in effect, trade U.S. technology and products for Middle East oil. But if our tax laws needlessly price U.S. companies out of the market, then the dollars we Americans spend for imports go in trade to third countries who are building the plants. Clearly, the U.S. is a net loser.

When our federal tax laws are inadvertently structured to price U.S. firms out of competition for foreign engineering and construction projects, we are jeopardizing foreign purchases of U.S. goods and services of tremendous value to the U.S., even though these foreign governments are friendly and would prefer to deal with U.S. firms.

In a new administration committed to exploring every reasonable avenue for providing jobs, here is a custom-tailored opportunity to at least prevent countless citizens in their most productive years from joining the unemployment rolls. For every U.S. expatriate on overseas assignment for Parsons and other like firms, there are 100 engineers and supporting personnel in our U.S. offices engaged in the design and procurement activities for those foreign projects. And for every dollar spent for these services, an additional 5 to 7 dollars is spent on these foreign projects to purchase U.S. equipment and material to be used in building these plants.

COPY

The Honorable W. Michael Blumenthal
January 26, 1977
Page three

In the aggregate, such foreign projects--mostly in the OPEC countries today--amount to many billions of dollars of U.S. goods and services exported each year in exchange for vitally needed and expensive petroleum supplies. At a time when the private sector is increasingly called upon to provide the tax revenues for expanding government services, we find ourselves handcuffed in our ability to respond, or perhaps even to survive.

I respectfully urge you to give high priority to a review and elimination of this punitive tax on overseas personal income that surely will be taking American firms out of the multi-billion dollar overseas construction market. U.S. business firms will get their share of the overseas work under anything approaching normal competitive conditions. We feel confident we can beat the foreign competition in management, sales, and technology. Our industry has not asked our government for subsidies or handouts. But what we expect of our government is the opportunity to compete on a reasonable and equitable basis with our foreign counterparts.

I have a keen appreciation for the heavy burdens you are assuming, and I wish you every success in your important undertaking. I know the subject matter of this letter is not of your making, but it does require urgent attention. If it would be helpful to you, I would be most eager to meet with you or your advisors to discuss the problem.

Respectfully yours,

W. E. Leonhard
President and
Chief Executive Officer

Testimony of

Neil W. Krumwiede

for

The Associated General Contractors of America

Presented Before the

Subcommittee on Taxation and Debt Management

of the Committee on Finance

U. S. Senate

June 26, 1980

On the Topic of

The Taxation of Americans

working abroad

AGC is:

- More than 30,000 firms including 8.000 of America's leading general contracting firms responsible for the employment of 3,500,000-plus employees;
- 113 chapters nationwide;
- More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utility facilities.
- Approximately 50% of the contract construction by American firms in more than 100 other countries

SUMMARY SHEET

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA SUPPORTS LEGISLATION WHICH WOULD PROVIDE MUCH NEEDED TAX RELIEF FOR AMERICANS WORKING OVERSEAS, WE BASE THIS POSITION ON THE FOLLOWING FACTORS:

1. CURRENT U.S. TAX POLICIES HAVE ERODED THE COMPETITIVE POSTURE OF THE U.S. CONSTRUCTION INDUSTRY IN THE OVERSEAS MARKETS DUE TO THE FACT THAT THE PROJECTS OUR FIRMS UNDERTAKE REQUIRE A HIGH UTILIZATION OF U.S. TECHNICAL AND MANAGEMENT PERSONNEL.
2. CURRENT U.S. TAX POLICIES ARE ALSO IN CONFLICT WITH U.S. TRADE AND FOREIGN POLICY OBJECTIVES AND, ALSO, WITH OUR NATIONAL SECURITY.
3. SECTION 911/913 TAX RELIEF WILL STIMULATE TRADE, EMPLOYMENT, OUTPUT AND COMBAT INFLATION BY REDUCING OUR NATION'S TRADE DEFICITS.

best copy available

Mr. Chairman, Members of the Committee:

My name is Neil Krumwiede and I am President of the Grove Overseas Corporation of Vienna, Virginia and a member of the International Construction Committee of the Associated General Contractors of America. Our firm has been active in the international construction markets for over 30 years and we have undertaken projects in numerous foreign countries. I personally worked on many of these jobs during my 20 years of experience as a project manager and project engineer.

I am accompanied here today by Mr. George E. Stockton, Director of AGC's International Construction Division.

Mr. Chairman, we appreciate the opportunity to appear here today on behalf of AGC and share with you our concerns on the current status of U.S. tax policies affecting the earned income of U.S. citizens working abroad. We have divided our statement into three sections, the first dealing with the competitive impact of the current law on our industry and our nation's overall trade performance, the second with the conflicting nature of these tax policies with other national priorities in the trade and non-trade areas and, finally, a section dealing with the political and economic realities of securing this greatly needed tax relief.

Part One - The Competitive Impact of Section 911/913 Taxation

In light of the extensive testimony presented by my fellow panelists on the subject of the macro trade impacts of the current law, I will refrain from commenting on these aspects. However, I would like to offer AGC's endorsement of these arguments as well as our unqualified support for their efforts in this regard. I would prefer to discuss briefly the competitive impact and the trade costs of the current law from a micro approach.

In March of this year, AGC conducted a study of a single $100 million construction contract which was bid by one of our member firms in the Middle Eastern country of Jordan.

Mr. Chairman, I would like to request that the study be entered into the hearings record and in the interest of time I will summarize its content. The project which was financed by the World Bank was awarded on a lump sum firm price basis and was open to international competitive bidding. Working with the contractor's estimators AGC staff worked up two separate bids for the same project, the first reflecting the costs of bidding the job with American personnel and the second, with British personnel. The bid included 50 management and supervisory positions for a 2 year period.

In the study we assumed that the U.S. and U.K. taxpayers would qualify for all tax benefits provided under current U.S./U.K. tax law. We found that the American staffed bid was approximately 3.3% or $3,322,548 more costly than the British staffed bid. Of this increased cost base salary difference amounted to only 21% of the total while 64% of the increased cost or $2,115,900 million was associated solely with the difference between U.S. and U.K. tax policies.

This project contained approximately $33,100,000 in U.S. expenditures and taxable bid items such as salaries paid to U.S. workers and corporate profit. The project would have generated $4.8 million in U.S. corporate tax revenues and $2.3 million in U.S. personal income tax revenues for a combined revenue of $7.1 million. Section 911 and 913 taxation would have generated an additional $2.3 million in revenue to the Treasury, however, this additional tax creates a competitive burden which is difficult to overcome, particularly on firm price contracts where a 2 to 3% spread between the first and second low bidder is not uncommon.

On contracts which are competitively negotiated foreign owners are becoming increasingly reluctant to pay the additional tax premiums associated with a large U.S. work force.

Mr. Chairman, the losers here appear to be the U.S. construction industry, which depends on qualified U.S. personnel to staff foreign projects, the U.S. Treasury which reduces the likelihood that any revenue will be generated from a foreign construction project by imposing additional non-competitive and unrealistic tax premiums on the project and, finally, the U.S. taxpayers who are forced to finance the unemployment and the lost tax revenues associated with the unsuccessful bid. Mr. Chairman, there is simply no justification for the maintenance of these archaic tax policies in today's increasingly competitive international market place.

Part Two - Section 911/913 Tax Policies and Competing U.S. Policy Objectives

There is increasing evidence that a sustained presence by the U.S. engineering and construction industry overseas is in the direct interest of the United States not only from a trade policy stand point but also from a foreign policy and national security perspective.

The United States is now planning to build U.S. military facilities in the Indian Ocean region to accommodate THE RAPID DEPLOYMENT FORCE strategy in the Middle East, at a cost to the taxpayers of approximately $500 million. The U.S. Army Corps of Engineers (Corps), and the U.S. Naval Facilities Engineer-Command (NAVFAC), will serve as the contracting officers for the construction. Both the Corps and NAVFAC had originally intended to allow foreign contractors to compete for the construction of these bases. A primary reason for this decision was the relative non-competitiveness of the U.S. construction industry

IN THE REGION. THIS DECISION WOULD HAVE VIRTUALLY PRECLUDED THE PARTICIPATION OF U.S. FIRMS IN THE CONSTRUCTION OF OUR OWN SENSITIVE MILITARY FACILITIES OVERSEAS AND WOULD HAVE ELIMINATED THE RETURN OF THE EMPLOYMENT, TAX, AND TRADE BENEFITS ASSOCIATED WITH THE EXPENDITURE TO THE U.S. ECONOMY.

FOLLOWING TESTIMONY BY THE AGC AND ORGANIZED LABOR BEFORE THE HOUSE AND SENATE MILITARY CONSTRUCTION SUBCOMMITTEES REPORT LANGUAGE WAS INCLUDED IN THE APPROPRIATIONS BILL WHICH WILL LIMIT THE CONSTRUCTION OF THESE BASES IN CERTAIN CASES TO U.S. FIRMS EMPLOYING U.S. TAXPAYERS. THE COMMITTEES RECOGNIZED THAT THESE CONDITIONS MAY INCREASE THE COSTS OF CONSTRUCTION, HOWEVER, THEY STATED IN THEIR RESPECTIVE REPORTS THAT "OVERRELIANCE ON FOREIGN SOURCE PROCUREMENT COULD ALSO JEOPARDIZE THE ABILITY TO MOBILIZE U.S. CONSTRUCTION CAPABILITY IN TIME OF CRISIS." WITHOUT A PRESENCE BY U.S. FIRMS IN THE OVERSEAS MARKETS THE UNITED STATES CANNOT RESPOND TO THE WORLD'S CHANGING STRATEGIC BALANCE OF POWER. NO OTHER SINGLE ISSUE HAS DONE MORE TO ERODE THIS PRESENCE THAN SECTION 911 AND 913 TAXATION.

THE UNITED STATES MAKES ANNUAL APPROPRIATIONS FOR FOREIGN ASSISTANCE TOTALING IN THE AREA OF $5 BILLION. THE VAST MAJORITY OF THESE FUNDS ARE CHANNELED INTO OUR BILATERAL ASSISTANCE PROGRAM, U.S. AID AND OUR SUBSCRIPTIONS TO THE MULTILATERAL DEVELOPMENT BANKS SUCH AS THE WORLD BANK AND THE INTERNATIONAL DEVELOPMENT ASSOCIATION (IDA). WITH THESE FUNDS THE MULTILATERAL BANKS UNDERTAKE LARGE CAPITAL DEVELOPMENT PROJECTS IN LESS DEVELOPED COUNTRIES UNDER INTERNATIONAL COMPETITIVE BIDDING PROCEDURES. THE U.S. CONSTRUCTION INDUSTRY HAS NOT WON A MAJOR WORLD BANK OR IDA FINANCED PROJECT IN THE LAST TWO YEARS AND PROSPECTS FOR OUR FUTURE PARTICIPATION IN THESE PROGRAMS IS NOT GOOD.

IN ADDITION OUR OVERALL CONTRIBUTIONS TO PROCUREMENT RATIOS IN THE MULTILATERAL BANKS IS EXTREMELY POOR WHEN COMPARED TO THE OTHER LEADING AID DONORS. FOR EXAMPLE, A BREAKDOWN OF 1978 SUBSCRIPTIONS TO PROCUREMENT PRODUCED THE

FOLLOWING RESULTS:

	World Bank		IDA	
	% of Subcriptions	% of Procurements	% of Subcriptions	%of Procurements
U.S.	23.0	20.5	30.4	11.9
Japan	4.6	22.4	10.5	15.6
France	4.4	7.8	6.3	10.6
U.K.	8.9	6.0	12.4	11.5
Germany	6.0	15.3	12.2	12.0

Aside from their developmental objectives one of the preceived policy benefits of these programs is that they establish a U.S. commercial presence in the borrower countries opening up new opportunities for trade. We submit that these objectives are not being met due to our relative non-competitiveness in the international markets. If we are going to continue to contribute our dollars to these programs it would be our recommendation that we do everything in our power to sharpen our competitive skills so that we may reap some return on our investment. Again no single issue has so undermined our competitiveness overseas as that of Section 911/913 taxation.

Political Realities of Section 911/913 Tax Relief

Mr. Chairman, AGC in conjunction with other business groups has been working on the issue of overseas tax relief for the last four years. The only concrete results we have gained from our endeavors to date outside of a very complex and confused tax policy, is a healthy respect for the politics of this issue. Critics of Section 911/913 relief have done a very effective job in misrepresenting the issue. They claim the primary beneficiaries of such relief are jet setting, mink clad Americans living in castles overlooking the Mediterranean. These efforts have succeeded in clouding the issue to the point that the Administration and the leadership in the Congress has been

UNWILLING TO FIGHT THE BATTLES THAT MUST BE WAGED TO FINALLY PUT THIS ISSUE TO REST.

THIS IS NOT A PURE TAX ISSUE, THIS IS A UNIQUE MIXTURE OF TRADE AND FOREIGN POLICY, NATIONAL SECURITY, DOMESTIC VS. INTERNATIONAL TAX EQUITY, AND, FINALLY, IT REFLECTS JUST HOW THIS COUNTRY VIEWS ITSELF IN THE WORLD MARKETS. THIS LAST CONSIDERATION IS PRESENTLY SENDING A VERY UNFLATTERING AND FRANKLY EMBARRASSING MESSAGE AROUND THE WORLD. WITH OUR PRESENT POLICIES WE ARE TELLING THE REST OF THE WORLD THAT IF THEY WANT OUR TALENT AND OUR EXPERTISE AND OUR EXPORTS FOR THAT MATTER THEY MUST BE PREPARED TO PAY A PREMIUM. A SPECIAL FEE THAT NO OTHER COUNTRY CHARGES FOR SIMILAR GOODS AND SERVICES.

THIS MESSAGE MIGHT HAVE WORKED SEVERAL YEARS AGO WHEN WE HELD TECHNOLOGICAL ADVANTAGES OVER COMPETING NATIONS BUT TODAY IT IS ALMOST LAUGHABLE AND THE FACT THAT IT IS STILL BEING SENT IS A CLEAR INDICATION OF WHY THIS COUNTRY'S PRESTIGE ABROAD IS AT SUCH AN ALL TIME LOW. IN OTHER WORDS, WE ARE BEING VERY ARROGANT WHEN WE HAVE VERY LITTLE REASON TO BE SO.

IN THE CONSIDERATION OF THE VARIOUS BILLS WHICH HAVE BEEN INTRODUCED WE WOULD URGE THAT THIS COMMITTEE FOCUS ON ALL OF THE ELEMENTS OF THIS ISSUE AND NOT BECOME SUBMERGED IN A SINGLE ASPECT OF THE DEBATE SUCH AS THE TAX EQUITY ARGUMENT. TAX EQUITY IS A VERY TEMPTING BANDWAGON TO CLIMB UPON, HOWEVER, AS ONE OF THE SPONSORS OF A SECTION 911/913 BILL HAS SAID, "TAX EQUITY DOES NOT TURN THE WHEELS OF OUR ECONOMY."

THE UPCOMING ANNOUNCEMENT BY THE ADMINISTRATION OF A TAX CUT, IN OUR OPINION, WOULD PROVIDE THE IDEAL VEHICLE FOR THE PASSAGE OF A MEANINGFUL FOREIGN TAXATION BILL. AS THE FIGURES AND STUDIES PRESENTED HERE TODAY VERIFY, SECTION 911/913 RELIEF WOULD STIMULATE INVESTMENT, OUTPUT, EMPLOYMENT AND WOULD, also, combat our inflation rate by reducing our mounting trade deficits. A Section 911/913 would therefore, in our opinion, meet all of the requirements of the classic supply side tax cut. There is nearly unanimous consensus among economists, including those in the Administration, that any tax cut package this year should be focused on the supply side of the economic equation rather than the demand side. We would encourage this committee during its consideration of such a tax cut package to give full consideration to the concepts outlined in the Jepsen, Bentsen and Chafee bills. We, as an industry, would favor the same tax policies utilized by other major competing nations. While we recognize the political ramifications of the unlimited income exclusion we are at the same time reluctant to pick a cap figure of $50 or 60 thousand only to see it whittled down by the tax equity proponents in an eleventh hour conference committee. We feel that a reasonable cap figure can be established if necessary but we also feel that the primary focus of the debate should be on the concept of the Jepsen bill.

In closing, Gentlemen, I would again like to stress the importance of this issue to the survival of our industry overseas. If we don't get relief this year you may see us again next year, but I doubt very seriously that we will have anything to talk about the following year if we are not successful in getting a bill through Congress in 1981. Thank you very much for the opportunity to appear here today and I would be pleased to answer any questions at this time.

PRESENTATION TO
SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
HEARINGS ON THE TAXATION OF FOREIGN-EARNED INCOME
JUNE 26, 1980

Good afternoon, my name is Richard Leonard, President of Hercules East, a division of Hercules Incorporated, Wilmington, Delaware. My responsibility is Hercules' business in the Far East from Pakistan to Korea, including Australia and New Zealand. Hercules is a $2.4 billion diversified company with operations in 30 states and 30 foreign countries. I have been personally associated with its exports for 20 years.

We now have 52 expatriates overseas, down from 75 in 1976, and in 1979 our exports reached $296,000,000; this, incidentally, was approximately 9 times the level when I entered the exporting business. We estimate that 3,700 employes, or about one of every six of Hercules U. S. employees rely on these exports for their jobs. Furthermore, our efforts create other U. S. jobs with Hercules suppliers and customers through a ripple effect on which I will comment later. Our exports are from many states in the U. S., but over 80% of the total come from: Georgia, New Jersey, Louisiana, Texas, Mississippi, Virginia, and North Carolina where we employ over 9,000 people.

With this background, you can see that Hercules has an active interest in the expansion of the international trade that is so important to U. S. employment, balance of payments, and general national economy.

Unfortunately, the U. S. has tended to lose position in international trade in recent years. For various reasons, including a tendency toward an increasing number of disencentives contrasted with the opposite approach. The introduction of incentives-by our trade competitor nations such as Japan, and Germany.

The taxation of foreign-earned income of individuals is clearly such a disincentive since we are the only major nation that adds this cost to locating its citizens abroad. I am confident that this added cost is a serious handicap to the competitive position of our export, and is a particular deterrent to new groups attempting start in the export field.

Our expatriates are highly trained in skills which are frequently unique to Hercules and our products many of which require special technical service in selling or in use.

Broadly speaking, Hercules' expatriates are required for marketing, technology, or critical administrative and communications functions. Their know-how is often required to help us in adapting U. S. products to local conditions.

The need for trained managers continues to grow, but the number of U. S. expatriates has and will continue to decline in part because of the U. S. tax treatment.

Let me cite some specific cases: First, a simplified case of how the U. S. tax treatment affects the cost of a U. S. expatriate in Japan (an important and hard to sell market).

Like most U. S. corporations, Hercules compensates its expatriates in a manner designed to avoid creating a penalty as a result of an overseas assignment. May I repeat the point for emphasis - the principle is to avoid penalty, not to increase income. This policy means that Hercules starts with the U. S. base salary of an individual, adds to that certain overseas allowances for housing, children's education, and adjustments for differences in living expenses in that country. These are truly valid extra expenses for avoidance of penalty - not added compensation. There is no way for the expatriate to pay a tax on this money because it is all expense. Therefore, the company must reimburse the individual for any additional foreign or U.S. tax. The payment for an expatriate's added income taxes artifically increases his U. S. taxable income which, in turn, causes Hercules to reimburse him for the payment of these additional taxes. The effect is a pyramiding one and, in effect, creates a tax on tax both in the U. S., and, since the U. S. requires this expense to be stated as income, also in Japan. The effect on a U. S. expatriate working in Japan in his second, third, and fourth years of foreign residence is drastic. For a $40,000 a year employee the total cost to Hercules escalates to $220,000 in the 4th year without any increase in salary or allowance.

The question is how we keep qualified men on the job to utilize their valuable newly developed knowledge? Incidently, this question is well known to the employees themselves and creates a serious personal concern for them as individuals. I suspect that those of you who attended the recent hearings on location in the Far East may have sensed this.

In addition to promoting directly the export of products manufactured by Hercules, expatriates also positively affect the export of equipment, engineering services, and products of other U. S. companies. For example, Hercules has two major joint ventures in Brazil. Significant portions of the equipment required for these projects has and will come from the U. S.. U. S. engineers overseas tend to specify U. S. equipment because they are familiar with it. Likewise, foreign nationals tend to specify equipment from their country of origin.

The purchase of U. S. source equipment not manufactured by Hercules will total up to $7 million for these projects in Brazil. This is what I previously called the ripple effect. Employment for these numerous equipment manufacturers is in 10 states (New York, Pennsylvania, Washington, California, New Jersey, Massachusetts, Virginia, Ohio, Oklahoma, Maine, and Texas.) created by Hercules expatriate activity abroad.

Another example is our expatriate in Pakistan where Hercules owns a 40 percent interest in a large fertilizer plant.

U. S. technology was used to build and maintain the plant. Substantial equipment exports were required which could very well have been foreign were it not for the familiarity and experience of expatriates with the U. S. process. The cost of maintaining expatriates in Pakistan is high and we have gradually reduced from 16 people to 1 in Pakistan. This one technically-trained individual has familiarity with the process and has the necessary management experience. In our opinion, further exports from the U. S. will be jeopardized-if in the future this business is expanded--as is logical--and there is no experienced American pushing for U. S. technology and equipment in the expansion.

Hercules operates worldwide in the food and fragrance business with substantial production facilities in Middletown, New York. Sale of these products requires a high degree of sophistication and up until recently, we had marketing organizations for exports in Singapore and Manila. In both cases these organizations were designed to increase exports of U. S. produced products. However, because of the lack of cost effectiveness of maintaining these organizations, both locations are curtailed as marketing centers. Simply stated, business generated for Middletown, New York, could not sustain the costs. This was in part due to the high cost of expatriate tax equalization.

To reduce the increased cost of expatriates, one obvious alternative is to transfer Hercules' overseas subsidiary personnel from one foreign country to another so that our sales development activity can continue unreduced.

This entails bringing Americans back to the U. S. where jobs must be found for them. Some actual transfers that have taken place are:

A Canadian to Brazil,

A Dutchman to Singapore,

A Nicaraguan to Venezuela.

These personnel moves do not provide the same levels of effective expertise that could be achieved by an American trained over a period of many years in the United States in the country where the product was developed. An even more important point is that this and the other examples do not create more employment in the United States nor jobs for U. S. citizens in overseas states. It has a negative effect on the number of jobs in the U. S.

RECOMMENDATIONS:

Since we believe the objectives of tax legislation in this field should be to maintain American business in a competitive posture, we recommend a positive approach like the Jepsen Bill (S.2321) which excludes taxation of all foreign-earned income, and in the alternative, the other bills (S.2418 introduced by Senator Bentsen, S.2283 introduced by Senator Chafee, and S.2814 introduced by Senator Mathias) which give recognition to these competitive factors which (if modified to help minimize the pyramiding effects of current practices) could be effective.

Given the urgency of the need for exapnded exports and the unique services that Americans provide in the marketing of U. S. made products, we believe that even if there is limited loss in tax revenue to the U. S. Treasury in the short-term, they are warranted by the economic benefits to be derived by everyone, including government.

I, therefore, urge that significant tax relief be provided for U. S. expatriates as proposed by these bills, particularly in the exclusion of expense reimbursements from gross income in one form or another, in any 1980 tax bill.

Thank you again for giving us this opportunity to testify on this import subject. I recognize and commend the effort that is being given by this and other Senate groups to a broad ranging export expansion program. Removal of disincentives like those we are discussing today is critical, but I have also seen what well designed incentive programs can do in growing countries like Japan, even in smaller economies like New Zealand, and hope you will broaden your efforts at a latter date.
We will be happy to provide you with any additional information or data, or consult with the appropriate staff members as you desire.

STATEMENT

by

SENATOR CHARLES McC. MATHIAS, JR.

on the

TAXATION OF AMERICANS LIVING OVERSEAS

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

June 26, 1980

Mr. Chairman. You are to be congratulated for scheduling these hearings and taking the initiative on this important issue. If we are ever going to get the country moving again economically, we have got to increase our exports.

The importance of exports to our economy cannot be overstated. One of every eight jobs in this country is involved with export; one of every three dollars of U.S. corporate profits comes from international activities; one of every three acres of farmland produces for export; and exports now contribute more to our GNP than private corporate investment does. Despite the importance of exports, the United States has lagged behind its major trading partners in promoting an aggressive export program. The Unites States' share of international commerce has decreased from 27.7 percent in 1958 to less than 19 percent in 1979. In 1978, American exports were 6.7 percent of our GNP while imports stood at 8.4 percent of GNP. Other major industrial nations in the world generally pay for the goods they import by what their exports earn. Our trade deficit has led to greater inflation and a dollar bleeding to death in world markets.

Much of the blame for our poor export performance can be pinned on the maze of disincentives to trade which the federal government has built up over the years.

Slowly, we are finding ways of reducing these barriers to trade. We have lowered our trade tariffs in return for similar concessions from our trading partners; we have reorganized the federal agencies responsible for administering our trade policies; and we are trying to promote reciprocity to make sure everyone plays by the same set of rules.

But more needs to be done. One thing we can do now is improve our policy on taxation of Americans living overseas. The United States is the only country that taxes its citizens living abroad. And, over the last four years, we have steadily increased the level of taxation and the complexity of the system. The result is clear--it now costs an American company $62,500 for an American worker in the Middle East to take home $27,500. And the damage is equally clear--the United States has fallen behind in its ability to win contracts abroad. Without American technicians on the job overseas, jobs back home are lost. If we don't encourage these Americans to remain abroad as good-will ambassadors, as a dedicated sales force, and as a foot in the door for other export opportunities, our balance of payments will grow increasingly out of whack and in the red.

Earlier this month, I introduced a bill, S. 2814, to eliminate the confusion and reduce the level of taxation for all Americans living abroad in all countries. This bill would allow a flat $50,000 tax exclusion on earned income while retaining four of the cost-of-living differentials currently allowed under Section 913 of the Tax Code.

If enacted, this bill would put American companies and American employees on an equal footing with their foreign competitors. It would give them a chance to bring back home some of the $60 billion dollars a year we are spending for foreign oil.

Our tax policy is costing the United States over $6 billion in lost trade, while the U.S. Treasury is gaining only $300 million in tax revenues. It doesn't take a Ph.D. in economics to figure out that this tax policy is short-sighted and misguided. The same impulse that prompted the much-ballyhoed crusade against the three-martini lunch led to our current policy. Its creators thought only in terms of rich movie stars living overseas in the lap of luxury on the Riviera. We've got to refocus our attention on the real world--on the hardworking men and women who are doing a tremendous, but increasingly difficult, job on behalf of all their fellow Americans. Rather than the Riviera, they will more likely be found in the desert heat or tropical monsoons of the less glamorous corners of the globe. Unless we make it possible to continue their important work, we'll all be in trouble.

My point is simple. If rational men and rational women were to sit down to devise a rational tax policy, they would not devise a policy anything like the one that burdens us today. Our trading partners do not labor under a similar burden, and we must get our laws in order if we are to compete in the international marketplace. My bill is a good place to start.

Statement of Hon Wendell Ford (D-Ky.)
Before the Subcommittee on Taxation
and Debt Management
Committee on Finance
United States Senate
June 24, 1980

Statement on S. 2493 -- A Bill to Extend the Time for Payment of Certain Excise Taxes

Mr. Chairman, I appreciate this opportunity to submit comments on S. 2493, a bill introduced by our colleague from Ohio (Mr. GLENN) to extend the time for payment of excise taxes on tires, tubes, and other products until 90 days after the close of the month in which the article is sold.

In my comments I will invite the subcommittee's attention to a problem of critical importance to one major industry in Kentucky, a problem which apparently parallels the problem of the tire industry in Ohio. The Kentucky industry is the tobacco industry, and the problem is the process of collection of Federal excise taxes on tobacco products.

After describing the unique hardships suffered by tobacco manufacturers in meeting the tax collectors' timetable, I will urge your subcommittee to report the Glenn bill with an amendment addressing the concerns of tobacco, as well as tire manufacturers.

Mr. Chairman, under current regulations in force since 1965, the Nation's six major cigarette manufacturers file excise tax returns twice each month. They have fifteen days after the close of each reporting period to pay all taxes due by check. Together these manufacturers remit to the Treasury, under this procedure, between $101.35 million and $113.37 million every fifteen days, according to the latest study conducted by The Tobacco Institute in 1979.

Although the manufacturers have fifteen days to file after the close of a reporting period, this is not adequate time for the industry to collect from its customers the amount due them to cover their Federal excise tax liability. This inequity results from the refusal of Treasury to "bond" regional warehouses; because tax liability accrues upon removal from bond, the taxes accrue in the case of cigarettes effectively upon removal from the factory premises on most shipments.

The net economic effect of the current system of tobacco excise tax collection is to place the industry in an average daily deficit position of $65,101,506 -- again based upon the 1979 Tobacco Institute study. The Federal tax collectors receive from the industry, on the average, some 60 percent of all taxes due before the industry taxpayers obtain remittance for those taxes from their customers.

Mr. Chairman, the present system is inequitable. But the proposed system , part of the President's cash management initiatives under study by your subcommittee, would be even more inequitable. Under the Administration's proposal, promulgated as proposed regulations in the *Federal Register* on June 6, 1980, the tobacco manufacturers would be required to remit taxes accrued within a seven day reporting period, upon removal from the factory premises, only three days after the close of the reporting period.

The net economic effect of this proposed plan, based upon data assembled and compiled for The Tobacco Institute by Coopers & Lybrand, would be to increase the industry daily deficit in its Federal excise tax account from $65 million to more than $206 million.

Notwithstanding the fundamental unfairness of such a procedure, the cost of capital to the industry to comply with the new procedure will be substantial. These costs will reduce earnings by the manufacturers, and thus reduce Federal income tax liability. The proposal -- billed as a cash management procedure -- will be counter-productive from the standpoint of Treasury revenues and should be opposed.

Mr. Chairman, the Treasury is of the view that an acceleration of Federal tobacco excise tax collections can be accomplished without legislation. Therefore, the regulations have been initiated earlier this month.

I share the concern of Mr. Glenn for the tire manufacturers of Ohio -- I trust that he and other Senators will express equal concern for tobacco manufacturers, who face filing returns every 7 days under the planned regulations.

Mr. Chairman, there is an uncomplicated way to deal with the Administration's effort to overreach in the collection of tobacco excise taxes. I simply suggest that Senator Glenn's bill be amended to include this language:

"At the appropriate place, add a new section as follows:

"SEC.______. Section 5703(b) of the Internal Revenue Code of 1954, as amended, is further amended by deleting the period at the end of the third sentence thereof, and by inserting the following:

":Provided, however, That the Secretary shall have no authority to prescribe regulations establishing a period for which such return shall be made, or the time for making such return, or the time for payment of such taxes, that would result in a shorter such period, or a lesser amount of time for making such return, or a lesser amount of time for payment of such taxes, as was prescribed by regulations in effect on January 1, 1980.".

Mr. Chairman, this simple amendment would preserve the status quo until Congress, and in particular your subcommittee, has had full opportunity to evaluate the entire process of collection of tobacco excise taxes. The amendment, I need not point out, would be an enormous relief to the major manufacturers of tobacco products in the Commonwealth of Virginia, the Commonwealth of Kentucky, and other adversely impacted states of this Union.

Thank you, Mr. Chairman, for the opportunity to comment on this worthwhile bill of Senator Glenn on the method of collection of Federal excise taxes.

THANK YOU

THE HONORABLE LLOYD BENTSEN
THE HONORABLE JOHN CHAFEE
UNITED STATES SENATE
WASHINGTON, DC 20510

DEAR SENATORS BENTSEN AND CHAFEE:

THE AMERICAN CHAMBER OF COMMERCE OF MEXICO, A.C. WOULD LIKE TO GO ON THE RECORD ON THE OCCASION OF THE JUNE 26, 1980 PRE-LEGISLATIVE TAX HEARINGS ON SECTION 911/913 OF THE INTERNAL REVENUE CODE.

THE AMERICAN CHAMBER OF COMMERCE OF MEXICO, A.C. WISHES TO EXPRESS ITS CONTINUED CONCERN OVER THE DECLINING PREDOMINANCE OF U.S. FOREIGN TRADE AND THE RELATION THAT RECENT TAX CHANGES IN SECTION 911/913 MAY HAVE HAD ON THIS DECLINE.

THE CHAMBER WOULD LIKE TO SUBMIT A REPORT, COMPLETED IN FEBRUARY 1980, ON THE RESULTS OF A QUESTIONNAIRE WHICH WAS SENT TO MANAGERS OF AMERICAN AFFILIATED COMPANIES DOING BUSINESS IN MEXICO. THIS QUESTIONNAIRE WAS DEVELOPED IN ORDER TO GET MANAGEMENT'S OPINION ON THE EFFECTS OF THE RECENT CHANGES IN SECTION 911/913 OF THE U.S. INTERNAL REVENUE CODE.

IN SUPPORT OF THIS CONCERN, THE CHAMBER WILL CONTINUE TO INVESTIGATE THE LINKED AREAS OF TRADE AND TAXES IN ORDER TO CONTRIBUTE TO THE STRENGTHENING OF THE PRESCENCE OF THE U.S. ABROAD.

RESPECTFULLY,

JOHN T. PLUNKET
PRESIDENT
AMERICAN CHAMBER OF COMMERCE OF MEXICO, A.C.

248302 CCUS UR
177130DACHAME

HIGHLIGHTED SUMMARY REPORT
OF THE
QUESTIONNAIRE SENT TO MANAGERS
OF AMERICAN AFFILIATED COMPANIES
DOING BUSINESS IN MEXICO

All questions referred to Section 911/913 of the Internal Revenue Service

56 questionnaires were sent out to the largest American multinational firms in Mexico with Americans in management positions--although the top management position, and therefore the person answering the questionnaire, was not always a U.S. citizen.

39 responses were received; this represented a response rate of 70%.

Of the responses received, 77% were answered by managers of U.S. citizenship.

92% of the companies reimburse their U.S. employees for excess taxes; 81 of these had a tax equalization policy.

56% of all responses indicated Americans had become too expensive to employ overseas.

77% of all managers answering believed the recent changes in U.S. tax laws would reduce exports and competitiveness abroad.

69% of all companies believed it was essential to maintain a large force of U.S. citizens abroad to service and promote U.S. products.

67% of the American managers responding believed that foreign employees in management positions would prefer doing business with their own country's firms rather than those of the U.S.

51% of the American managers indicated they had encountered a lack of enthusiasm on the part of American personnel for overseas assignments.

55% of all the managers who gave only one response to the question as to how Americans abroad should be taxed, indicated that foreign-earned income and allowances should be tax free.

REPORT ON THE RESULTS OF THE
QUESTIONNAIRE SENT TO MANAGERS
OF AMERICAN AFFILIATED COMPANIES
DOING BUSINESS IN MEXICO

Due to the concern expressed by many Americans living in Mexico over the recent changes in Section 911/913 of the U.S. Internal Revenue Code, and because certain U.S. public sector officials appear to be interested in reassessing these changes with a view toward judging their fairness and long term effects, the U.S. Public Sector Liaison Committee of the American Chamber of Commerce of Mexico, A.C. developed a questionnaire for managers of American affiliated companies doing business in Mexico. The purpose of the questionnaire was to assess how the U.S. tax laws have affected American affiliated companies in Mexico and the companies' relations with their U.S. employees based in Mexico.

The questionnaire was sent to 56 of the largest multi-national American companies. These companies were chosen on the basis of major U.S. capital investment, and because they all had one or more Americans in management positions--although there were several companies where the top management position was held by a non-U.S. citizen. Each questionnaire was carefully coded so that there was no question of receiving responses from anyone but those companies we had selected, and so that answers from the top American managers could be separated, if necessary, from those returns which came from non-U.S. managers who might have Americans working for them in management positions, but who might not be as knowledgeable or as sensitive to the U.S. income tax laws. Of the 56 questionnaires which were sent out, 39 answers were received--representing the amazingly high response rate of 70%. Of the 39 responses, 30 (representing 77%) came from American managers; the other 9 answers (representing 23%) came from non-U.S. citizens who manage American affiliated companies and who have Americans working for them. All questions referred to Section 911/913 of the Internal Revenue Code.

Question 1 dealt with the number of Americans in management positions versus the total number of management positions. In the 39 companies which responded to the questionnaire, there were 3,204 management positions of which Americans held 246 positions--representing 7.7%.

Question 2 dealt with whether the company had a policy to reimburse expatriate U.S. citizen employees for foreign taxes incurred in excess of what would be a normal tax burden. Of the 39 companies responding, 92% responded in the affirmative. The other 8% indicated they had no such policy, and that the employee paid any and all taxes to the U.S. and Mexico.

Of those answering in the affirmative, 81% indicated they had a tax equalization policy; 17% indicated no answer; and 2% indicated they had a complicated loan system.

Question 3 dealt with the possibility of increased costs companies had incurred due to the effects that changes in U.S. tax laws had had on them. Of the 33 companies which gave one or no responses to this question, 15% gave no answer, 55% indicated that the local company was absorbing these costs, 24% indicated that the parent company in the U.S. reimbursed the local company for the increased costs, and 6% indicated that they were replacing American employees with local or third country nationals.

Of the 6 companies which gave 2 answers to this question, all (that is 100%) indicated they were replacing American employees with local and third country nationals (taken in context with all companies which gave this response, 21% indicated they were replacing American personnel with non U.S. employees); the second answers were divided as follows: 67% indicated that beyond replacing American personnel, the local companies were absorbing the increased costs, and 33% indicated that the U.S. parent company was reimbursing the local company for the increased costs.

Question 4 asked what these possible increased costs, due to changes in the U.S. tax laws, might mean in monetary terms. The following calculation was requested to determine a percentage: increased costs divided by total base payroll. All companies which returned the questionnaire answered something to this question,which lead one to believe that they all had some increased costs. 72% could give no calculation; of the 28% listing percentages,these ranged from less than 1% to as high as 15%, although most were in the 1 or less percentage range.

Question 5 asked if the companies were repatriating American management employees. 69% answered no, and 31% indicated they were repatriating American management employees. This is important because when this question was asked directly, as opposed to question 3 which was more obscure, the companies answering in the affirmative were up 10% points.

For those answering in the affirmative, these were asked to indicate what % of American management employees this represented. The answers were as follows: 8% gave no answer; 17% indicated they were repatriating between 0 - 9%; 42% were repatriatiang between 10 - 29%; 8% were repatriating between

30 - 49%; and 25% were repatriating between 50 - 100%.

These same companies which had indicated that they were repatriating American management employees, were asked to indicate why. 17% indicated this was due solely to the effects the changes in U.S. tax laws were having on them; 33% indicated this was due solely to other factors having nothing to do with the changes in U.S. tax laws; 42% indicated this was due to a combination of changes in the U.S. tax laws and other factors; and 8% indicated the changes in Section 911/913 were only accelerating previously programmed replacement plans. What is important to note here is that 67% of the companies repatriating American management personnel were doing so directly or indirectly because of the changes in the U.S. tax laws.

Question 6 asked the company managers if they worried about a "ripple effect"; that is that a contract lost due to the higher cost of tax reimbursements by a primary U.S. company might affect the operations of the group. The answers were as follows: 3% gave no answer, 10% answered in the affirmative, and 87% indicated that they did not worry about a "ripple effect". Despite the fact that only 3% gave no answers, it was the feeling of those collating the answers, that this question was not understood properly by those responding to it and/or that despite the fact that there are many American multinational firms in Mexico, very few of these have subconstractors belonging to the same American multinational group.

Question 7 dealt with whether American citizens were becoming too expensive to employ overseas. Of the 39 company managers responding, 56% answered in the affirmative and 44% said no. When this was further divided between the responses from American managers and those which are non U.S. citizens, the American managers answered in the affirmative by 60%.

Question 8 asked the managers of these American companies, if they thought that the recent changes in the U.S. tax laws would reduce U.S. exports and competitiveness abroad. Of the responses received, 77% answered yes, 18% answered no, and 5% gave no answer. When these same answers were analyzed for the responses from the American managers alone, the answers were as follows: 77% answered yes, 20% answered no, and 3% gave no answer.

Question 9 asked if the U.S., in order to remain competitive, should maintain a large force of U.S. citizens abroad to promote and service U.S. products and operations. The responses from all managers were: 67% answered in the affirmative, 31% answered no, and 2% gave no answer. When this question was put to only American managers, the responses were as follows: 77 % answered in the affirmative, 20% answered no, and 3% gave no answer.

Question 10 asked managers, if a company lost or replaced its American employees abroad with local or third country nationals, did they think foreign employees in management positions would prefer doing business with their own country's firms rather than those of the U.S. 59% of all the responses were in the affirmative, 36% answered no, and 5% gave no answer. The responses taken from American managers indicated that 67% believed this to be so, 27% answered no, and 6% gave no answer.

Question 11 asked if company managers had been under pressure from local or third country nationals to receive compensations equal to what an American employee was "apparently" receiving. The responses from all managers indicated that 44% had been under this pressure, 53% answered no, and 3% gave no answer.

Yet when this same question was limited to the responses from American managers, their answers were: 54% had been under pressure, 43% answered no, and 3% had no answer.

Question 12 asked if managers had encountered any lack of enthusiasm on the part of American personnel for overseas assignments because of the changes in Section 911/913 of the tax laws. Of all responses received, 51% answered in the affirmative, 44% answered no, and 5% gave no answer. When this question was put simply to the American managers, 57% answered yes, 36% answered no, and 7% gave no answer. The answers to this question would probably be more valid if the question were put to the company officials in the home office in the U.S. The home office of the American company is probably more aware of the job offers given and refused.

Question 13 asked if the company was considering closing its operations in Mexico as a result of the U.S. tax law changes. These responses were as follows: 92% answered no, 3% answered yes, and 5% gave no answer. There was no difference in the responses from American managers.

Question 14 asked if the managers of these American affiliated companies had heard expressions of concern from Mexican government officials over the effects the changes in U.S. tax laws might have on U.S. investments in Mexico. These responses were as follows: 48% indicated that the tax issue had not been discussed, 44% answered that no concern had been expressed, 5% answered in the affirmative, and 3% gave no answer.

Question 15 asked how Americans residing abroad should be taxed. For those who only marked one response, the results were as follows: 55% felt foreign earned income and allowances should be tax free, 36% believed in granting a partial tax break on foreign earned income and overseas allowances by authorizing full or partial deductions and/or authrizing exclusions ranging from $15,000 to over $35,000, and 9% believed in eliminating provisions which created hardships or which were specifically unfair to Americans residing abroad, such as the taxation of moving expense reimbursements and the application of source rule on days spent within the U.S. on business which generated double taxation. For those who gave 2 or more responses to this question, 100% marked the making foreign earned income and allowances tax free as at least one of their answers; the other responses were similar to the answers given above. When this same question was put simply to American managers of American affiliated companies, the figures remained the same.

As stated earlier, all questions referred to Section 911/913 of the Internal Revenue Code. The questionnaire was sent to 56 managers of the largest American multinational companies in Mexico, from which the Chamber received responses from 70%.

The U.S. Public Sector Liaison Committee of the American Chamber of Commerce of Mexico, A.C. would like to suggest that the Congress of the United States re-examine the tax laws affecting American citizens residing abroad. The Committee, based on this report, specifically would like to suggest that Congress consider giving American citizens residing abroad a complete tax exemption. This would make the U.S. competitive with other countries, and eliminate some of the disadvantages it currently faces.

In the event that Congress could not accept issuing a complete tax exemption to Americans residing abroad, the Committee then would like to suggest that consideration be given to the elimination of some of the provisions which create hardships or are unfair, such as the taxation of moving expense reimbursements and the application of source rule on days spent within the U.S. on business. In addition, the Committee would like to recommend that Congress consider giving Americans abroad a credit for the liability they face with regard to the high cost of foreign indirect taxes for which no relief is presently available.

It is the belief of the American Chamber of Commerce of Mexico, A.C. that a solution should be found in order to make the taxation of American citizens residing abroad more equitable, and that Congress, in the same context, should consider what steps should be taken to protect U.S. export goods so as to keep them competitive.

american chamber of commerce of mexico, a. c.
lucerna 78 méxico 6, d. f. tel 566-08-66

QUESTIONNAIRE OF THE UNITED STATES PUBLIC SECTOR LIAISON COMMITTEE FOR MANAGERS OF AMERICAN AFFILIATED COMPANIES DOING BUSINESS IN MEXICO

The U.S.P.S.L. Committee of the American Chamber of Commerce of Mexico, A.C. is interested in knowing how recent changes in the United States tax laws have affected American affiliated companies in Mexico and the company's relations with its U.S. employees based in Mexico.

We have reference to:

Section 911/913 of the Internal Revenue Code

1. **In your company how many management positions are held by Americans?** ____________________
   ***Please indicate total number of people in management positions:** ____________________
2. **Does your company have a policy to reimburse expatriate U.S. citizen employees for foreign taxes incurred in excess of what would be considered a normal tax burden?**
   ( ) Yes
   ( ) No
   If yes, please describe briefly: ____________________
   ____
   ____
3. **If your company has increased costs due to the effect that changes in U.S. tax laws are having on your company, how is your company handling them?**
   ( ) absorbing them
   ( ) having parent company reimburse them
   ( ) replacing American employees with local or third-country nationals
   ( ) other: ____________________
4. **If your company reimburses its American employees for the increased costs due to U.S. Section 911/913 tax changes, what % of your total base payroll does this represent?** ____________________
   *** * Calculation: increased cost divided by total base payroll.**
5. **Have you or are you repatriating American management employees?**
   ( ) No
   ( ) Yes
   If your answere is yes: how many?
   ( ) 0- 9%
   ( ) 10- 29%
   ( ) 30- 49%
   ( ) 50-100%
   If your answer is yes, is it:
   ( ) Due solely to the effect the changes in U.S. tax laws are having on your company.
   ( ) Due solely to other factors having nothing to do with the changes in U.S. tax laws.
   ( ) Due to a combination of the changes in U.S. tax laws and other factors.
   ( ) The changes in Section 911/913 are only accelerating previously programed replacement plans.
6. **Do you worry about a "ripple effect"? I.e. A contract lost due to the higher costs of tax reimbursements by a primary U.S. company may affect other operations of the group:**
   ( ) Yes
   ( ) No
7. **Since the foreign earned income exclusion has been repealed, do you think that U.S. citizens have become too expensive to employ overseas?**
   ( ) Yes
   ( ) No

Please circle

8. Do you think that the recent changes in the U.S. tax laws will reduce U.S. exports and competitiveness abroad? Yes No

9. Do you believe that if the U.S. is to remain competitive, it is essential to maintan a large force of U.S. citizens abroad to promote and service U.S. products and operations? Yes No

10. If a company loses or replaces its American employees abroad with local or third country nationals, do you think foreign employees in management positions may prefer doing business with their own country's firms rather than those of the U.S.? Yes No

11. Has your company been under pressure from local or third country nationals to receive compensations equal to what an American employee is "apparently" receiving? Yes No

12. Have you encountered any lack of enthusiasm on the part of your American personnel for overseas assignments because of the changes in Section 911/913 tax laws? Yes No

13. Are you considering closing your operations in Mexico as a result of the U.S. tax laws changes? Yes No

14. To your knowledge, have Mexican government officials expressed concern over the effect the changes in U.S. tax laws will have on U.S. investment in Mexico?

- **( ) Yes**
- **( ) No**
- **( ) The tax issue has not been discussed.**

15. Americans residing abroad should be taxed by:

- **( ) Taxing all earned income and overseas allowances.**
- **( ) Granting a partial tax break on foreign earned income and overseas allowances by:**
  - **( ) authorizing full or partial deductions**

    and/or
  - **( ) authorizing exclusions of:**
    - **( ) $ 15,000**
    - **( ) 20,000**
    - **( ) 25,000**
    - **( ) 30,000**
    - **( ) 35,000 or +**
- **( ) Making foreign-earned income and allowances tax free.**
- **( ) Indexing taxation to foreign inflation rates.**
- **( ) Eliminating provisions which create hardships or are grossly unfair to the American abroad, such as:**
  - **( ) taxation of moving expense reimbursements.**
  - **( ) application of source rule on days spent within the U.S. on business, which generates double taxation.**
- **( ) Others, specify: ______________________________**

NATIONAL FOREIGN TRADE COUNCIL, INC.
10 ROCKEFELLER PLAZA • NEW YORK, N. Y. 10020 • (212) 581-6420

June 25, 1980

Mr. Michael Stern
Staff Director
Senate Finance Committee
2227 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Stern:

The National Foreign Trade Council, a non-profit organization whose membership comprises a broad cross-section of over 600 U.S. companies with highly diversified interests engaged in all aspects of international trade and investment, is pleased to submit comments on S. 2283, S. 2321 and S. 2418. The basic thrust of these bills is to substantially liberalize the existing rules relating to the taxation of foreign earned income of Americans overseas.

We wish to express our support for the concept embodied in each of the three proposals since each would, if enacted, represent a substantial improvement over existing law. The present U.S. system for taxing expatriates is unnecessarily complex and costly to U.S. business. In contrast to the U.S., the other major industrial nations do not even tax the foreign earned income of their citizens. Whether or not such exemption is a wise policy, it must be recognized that it is the almost universal international practice of expatriate taxation today. Because the U.S. system does not conform to international practice, our members have found that it puts U.S. business at a substantial trade disadvantage.

The U.S. first taxed foreign income to correct what was considered to be an abuse of the tax system by a few highly paid individuals. Through a succession of revenue acts, culminating in the Foreign Income Act of 1978, the U.S. tax burden on citizens abroad became more burdensome and complex. Most U.S. corporations have a tax equalization program which reimburses employees for taxes attributable to their foreign employment. That tax reimbursement, as well as other allowances related to the foreign assignment, is included in the

Founded in 1914, the National Foreign Trade Council, Inc. is a private non-profit organization for the promotion and protection of United States international trade and investments.

U.S. taxable income of the employee, thereby increasing his U.S. tax liability. Since that additional liability is reimbursed to the employee by many firms under their tax equalization program, they are finding it prohibitive to keep U.S. expatriates abroad. They have been forced to replace U.S. nationals with foreign citizens not subject to home country taxation. In addition, many U.S. contractors bidding on foreign projects have been losing bids to foreign based competitors because of the higher cost of using U.S. employees on foreign projects, largely attributable to the additional tax cost.

The President's Export Council, in a report dated December 5, 1979, points out that the replacement of U.S. citizens by foreigners abroad has resulted in a sharp loss of American business abroad. This loss of business to foreign competition reduces the number of U.S. jobs and increases our balance of payments deficit.

The Chase Econometrics study "Economic Impact of Changing Taxation of U.S. Workers Overseas" (published June 1980), reiterates and quantifies this conclusion. Some 80,000 jobs would be lost in 1980, and a drop of $12 billion in export dollars would result if U.S. exports diminish by 5%. The 5% reduction is not arbitrary. The Chase study states on page 27:

> "The presence of Americans overseas helps generate export business. In response to GAO's 1977 survey, 88% of overseas affiliates of U.S. companies estimated that U.S. exports would decline by at least 5% if the 1976 legislation were implemented. In addition, a 1978 study by Treasury's Office of Tax Analysis projected that a decline of 10% in the number of overseas workers would result in a 5% decline in real exports. Many overseas Americans are involved in work which involves substantial procurements or the potential for large amounts of follow-on work. They also tend to be employed in highly skilled positions, thus involving the export of high value-added services rather than lower value-added commodities and products.
>
> The reduction in exports due to the tax change is difficult to quantify with precision, but responses from hard-hit firms are indicative of the type of effects which have occurred and as a result of the Tax court decision and the 1978 legislation:..."

We believe that a liberalization of the rules for taxation of expatriates is essential to enhance the competitiveness of U.S. international business. At a time when the United States is in a severe recession, every effort should be made to improve the foreign business of American firms in order to create more export-related jobs at home and improve our balance of payments. Therefore, we recommend that the Congress act at the earliest possible time to liberalize Sections 911 and 913 to eliminate the disadvantage currently faced by American business.

It is respectfully requested that these comments be made part of the record of the hearings held on June 26th, 1980.

Respectfully submitted,

Carter L. Gore
Director
Tax/Legal Division

CLG:acf

TESTIMONY OF ROBERT GURLAND FOR THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT IN SUPPORT OF S 2321

I am an American citizen, a member of the Bar of the State of New York, admitted to practice before the Supreme Court of the United States of America and the United States Tax Court. I am a partner in a law firm with a substantial practice in London. I specialize in tax matters. For the past ten years I have been living and working abroad. I am an independent voter from the State of New York and vote regularly in U.S. Federal elections. My eldest son will be attending Emory University in Atlanta, Georgia in September.

Much of our practice involves business transacted between the United States and other countries. Many of our friends and clients are Americans living and working abroad both in the United Kingdom and elsewhere. Most of them have significant economic problems resulting from adverse U.S. tax legislation which discriminates against Americans residing abroad. Consequently they are not able to compete with their foreign counterparts.

Unlike most countries, the U.S.A. taxes on the basis of citizenship rather than residence. As a consequence, non-resident American citizens and companies are subject to U.S. taxes on foreign income which is also subject to tax in their country of residence. Existing double tax treaties, which are theoretically designed to prevent double taxation, are generally geared to systems which tax on the basis of residence rather than citizenship. Yet the U.S. does not relieve its non-resident citizens from the burden of U.S. tax. Consequently these treaties have much less value to U.S. citizens than they do to citizens of other countries.

Most other countries do not tax the income of their citizens who live and work abroad. This encourages export trade and helps their balance of payments. In addition, it helps to provide their citizens with employment and operates as an informal system of foreign diplomacy which tends to help us develop good relationships with other countries. It is obvious from experience in recent years that the U.S.A. is in need of improving its balance of payments, improving its image abroad and improving its employment position.

Statistics indicate that past value of income taxes paid by Americans living and working abroad is negligible compared to the benefits which have been earned by the United States in increased business and benefits to the balance of payments. In any event, much of the profits earned abroad by U.S. citizens and businesses are in fact taxed in the hands of U.S. companies which employ Americans, or have subsidiaries abroad.

My experience has been that most Americans living abroad are not employed by large companies which make tax equalization payments for them. Rather, most overseas Americnas are entrepreneurs and small, closely held businesses which do not provide the "fringe benefits" available to employees of large companies. The extra tax burden imposed in having to pay U.S. taxes as well as local taxes (including non-deductable rates and Value Added Tax), suffering from a much higher cost of living and not being able to take advantage of free schooling in the U.S.A., Medicare and other services which are available automatically to people living in the United States, has forced many people to go out of business to their detriment and to America's detriment. In addition, there are many people who are less advantaged, such as teachers and retired people, who live on limited incomes and who cannot afford the burden of any additional taxes.

For all of the above reasons, it is reasonable and equitable that U.S. citizens living abroad be exempted from all U.S. income tax on foreign source earnings. This will put them on equal footing with their foreign competitors and will ultimately be to the financial benefit of the United States of America. Furthermore, this would eliminate the need for "Indexing" which is an expensive and pointless procedure. Each year vast armies of people, paper and regulations must be issued to show the differentials in cost of living between the United States and 100 or so foreign countries. The cost is not worth the return. Eliminate the tax and profit from a better balance of payments, a stronger dollar and fuller employment.

Respectfully submitted

Robert Gurland
Crotti & Gurland

June 18, 1980

UNIVERSITY OF MARYLAND UNIVERSITY COLLEGE
UNIVERSITY BOULEVARD AT ADELPHI ROAD, COLLEGE PARK, MARYLAND 20742

OFFICE OF THE
CHANCELLOR

STATEMENT BY UMUC IN SUPPORT OF SENATE BILL 2283

The University of Maryland University College strongly supports Senate Bill S. 2283 to amend the Foreign Earned Income Act of 1978 in order to correct the hardship which the new law has created for the faculty and staff of U.S. universities and colleges offering educational programs in foreign countries.

Section 911(c) of the IRS Code of 1954 and the Tax Reform Act of 1976 provided that U.S. citizens who reside in foreign countries and who receive compensation for personal services, other than from U.S. government employment, were eligible for exclusion of some or all of such income from their annual income tax liability. Under this provision, faculty and staff of U.S. universities and colleges, as well as members of other charitable organizations, have qualified for an exemption of up to $20,000 of earned income.

While we appreciate the reasons for the repeal of Section 911 and the partial and conditional reinstatement of some of its benefits by the Foreign Earned Income Act of 1978, the effect of this act represents a significant hardship for our faculty and staff because they serve overseas under conditions different from those of U.S. citizens employed overseas by private corporations.

The Foreign Earned Income Act of 1978 establishes in Code Section 913 a series of tax deductions for excess living, housing, educational and other expenses incurred by Americans (both charitable and non-charitable) living and working abroad. The $20,000 income exclusion provided under Section 911 to all workers in the past has been modified and retained for optional used by corporate employees in remote camps only.

U.S. corporate employees stationed in foreign countries are generally well-paid and living in high-cost cities of Europe, Asia, and Latin America. For them, the Section 913 cost-of-living deductions provide the protection from unfair taxes which were originally intended by the Foreign Earned Income Act of 1978.

The salaries of faculty and staff of university personnel overseas follow the same salary guidelines established by the State and by the university. A recent survey published in the Chronicle of Higher Education demonstrates the fact that salaries of university or college faculty are significantly lower than those in the private or federal sector, and that their increases over the last decade trail considerably general inflationay increases. As State and university employees, they also do not receive benefits that are customary for employees of private companies and corporations. Although the Foreign Earned Income Act of 1978 provides for deductions for certain living expenses abroad, such deductions will not make up for the loss of the $20,000 income exclusion.

The loss of the tax benefits that were originally provided by Section 911 of the IRS Code and retained by the Tax Reform Act of 1976 severly curtails recruitment of qualified faculty and staff overseas. Personnel in the lower income brackets, such as junior faculty or clerical staff, will suffer most under this loss. Ultimately, the change in tax status threatens the continuation of our programs overseas.

THE WORLDWIDE CONTINUING EDUCATION CAMPUS

The problems of faculty and staff retention and/or recruitment has become especially crucial for universities and colleges involved in education for the military overseas since the tax incentive for their faculty and staff was lost. The tuition rates which are charged military personnel and which are partially subsidized through tuition assistance by the federal government represents a carefully negotiated agreement between the institutions of higher education and the local military command in order to keep the tuition cost as low as possible. The loss of the tax incentive for their faculty and staff would require payment of higher salaries and thereby result in an increase in tuition rates; we believe this tuition increase would increase the related cost to the government in excess of the estimated reduction of budget receipts under Bill S.2283, as well as disadvantaging lower rank service personnel who are most in need of educational opportunities.

We urge your support for Senate Bill S.2283, reinstating the foreign income exclusion for U.S. citizens employed by educational and/or charitable institutions, as defined by Section 501(c)(3), respectively included in the Cumulative List of Organizations described in Section 170(c) of the 1954 IRS Code.

We will be happy to provide any additional information that you desire.

HS/ug
6/23/80

MACHINERY and ALLIED PRODUCTS INSTITUTE
1200 EIGHTEENTH STREET, N.W. WASHINGTON, D.C. 20036 202-331-8430

June 24, 1980

The Honorable Harry F. Byrd, Jr.
Chairman
Subcommittee on Taxation and
Debt Management
U.S. Senate Committee on Finance
Dirksen Senate Office Building, Room 2227
Washington, D.C. 20510

Attention: Mr. Michael Stern
Staff Director

Dear Chairman Byrd and Members
of the Subcommittee:

Bills To Amend the Foreign Earned Income Exclusion and Excess Foreign Living Expense Deductions

Introduction

In connection with public hearings to begin shortly, the Machinery and Allied Products Institute (MAPI) is pleased to have this opportunity to comment to the U.S. Senate Finance Subcommittee on Taxation and Debt Management concerning three bills that have been introduced to reform the Internal Revenue Code Section 911 foreign earned income exclusion and the Code Section 913 excess foreign living cost deductions.

Pending Legislation

To summarize, S. 2283, introduced by Senator Chafee of Rhode Island, would provide an off-the-top annual income exclusion of $50,000 for foreign earned income for persons who are bona fide residents of a foreign country. Up to $65,000 per year would be excluded where the individual is a bona fide resident for at least three consecutive years. In addition, a special exemption for housing allowances in excess of 20 percent of earned income would be provided.

S. 2418, introduced by Senator Bentsen of Texas, would provide an off-the-top annual exclusion of up to $60,000 for foreign earned income. The deduction for certain housing expenses

MACHINERY & ALLIED PRODUCTS INSTITUTE AND ITS AFFILIATED ORGANIZATION, COUNCIL FOR TECHNOLOGICAL ADVANCEMENT, ARE ENGAGED IN RESEARCH IN THE ECONOMICS OF CAPITAL GOODS (THE FACILITIES OF PRODUCTION, DISTRIBUTION, TRANSPORTATION, COMMUNICATION AND COMMERCE) IN ADVANCING THE TECHNOLOGY AND FURTHERING THE ECONOMIC PROGRESS OF THE UNITED STATES

under Section 913 of the Code would be retained, and the tax treatment under Section 119 of lodging furnished to employees living in camps would also be modified. The existing cost-of-living differential, schooling deduction, home leave travel deduction and hardship area deduction provisions would be repealed.

S. 2321, introduced by Senator Jepsen of Iowa would provide that all foreign earned income of certain individuals is exempt from U.S. taxation. There would be no change in the law regarding so-called unearned income, such as interest and dividends.

MAPI Position, in Brief

To recite MAPI's position in brief, we believed that the Tax Reform Act of 1976 literally was a "disaster" as it affected the foreign earned income exclusion--a case study in policy error that in public hearings we resisted to no avail other than to help put it in suspense after enactment. Then, the Foreign Earned Income Act of 1978 was concocted as a partial and rather awkward act of retrenchment that still failed to deal properly with the problem, and MAPI through public presentation tried in vain again to steer Congress away from the untenable compromise that it eventually enacted.

We are delighted that the Subcommittee has returned to this area of the tax law, and that all of the bills under consideration move decidedly in the direction we have advocated.

General objectives.--We do not intend to be doctrinaire about special proposed "cures" to the Section 911-913 malaise, because we still confront major obstacles to obtaining relief, including some persons in the current Administration who apparently do not yet realize what is at stake and refuse to consider any relief that is not funded by tax increases elsewhere. However, our position--in broad outline--is to obtain tax treatment for overseas U.S. workers that is fair in a general sense and is as nearly coordinated with the tax treatment of our foreign trading partners for their expatriates as can be arranged.

Stated another way, we acknowledge that there are some equity considerations to be weighed as among domestic and overseas U.S. taxpayers in their own right. However, there also are certain factors to be evaluated with respect to international competitiveness, tax harmonization, administrative burden, tax simplifcation, and "neutrality" of the U.S. tax Code, as they bear on decisions in a larger framework extending beyond our own borders.

More specific goals.--More specifically, we have continuously advocated retention of the Code Section 911 exclusion in the form enacted in the early 1960s, with the excluded amount to be increased to reflect inflation since then. The basic purpose of the exclusion was to help avoid overlapping and discriminatory taxation of foreign earnings of U.S. workers overseas, and this objective obviously cannot be met in an inflationary environment with only a narrow, limited, foreign tax credit and a flat dollar exclusion kept at levels established many years ago. Neither does it make sense, in our opinion, to use special Code Section 913 deductions to "refine" this narrow area of the tax law at the expense of the complication and administrative burden that is thereby introduced.

Any bill that yields an approximation of the result we seek will be a quantum leap forward from the ineffectual "Rube Goldberg" apparatus that now exists, and we urge the Subcommittee to act soon and not allow the opportunity to pass.

Emphasis on Trade

Let us emphasize, in our opening remarks, that the "trade" element of the policy decision implicit in the bills under question is a major one to be reckoned with and necessarily has a bearing on what is done. In General Accounting Office (GAO) Report No. ID-78-13 of February 21, 1978, entitled "Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas," GAO advised the Congress, as follows:

> Because of the seriousness of the deteriorating U.S. international economic position, the relatively few policy instruments available for promoting U.S. exports and commercial competitiveness abroad, and uncertainties about the effectiveness of these, serious consideration should be given to continuing Section 911-type incentives of the Internal Revenue Code, at least until more effective policy instruments are identified and implemented./1

In our judgment, Congress essentially refused to follow the advice of its own investigative arm in 1978, because the 911-913 mishmash adopted at that time could not rationally be mistaken for a "more effective policy instrument" than the pre-1976 Act general exclusion that it replaced. Now, the same questions must be revisited again.

Our further, more detailed comments constitute the remainder of this statement.

Detailed Comments

Our further remarks are concentrated on (1) foreign trade considerations; (2) tax harmonization and simplification; and (3) the bills before the Subcommittee.

Foreign Trade Considerations

Export Council's views.--We commend to the Subcommittee's attention the Report of the President's Export Council Task Force on the Tax Treatment of Americans Working Overseas.

1/ Page vi.

Whatever position the current Treasury officials may take on this question, the Export Council's Subcommittee on Economic Expansion is intimately aware of the linkage between domestic economic growth and having U.S. citizens in overseas service in the private sector. According to the Export Council's Subcommittee, Americans working overseas are "essential" to a viable export program. "An increase in the number of Americans assigned abroad can increase our exports, reduce the negative balance of payments, enhance our country's image, and raise employment in the United States."

Cost of U.S. workers abroad.--As the Subcommittee on Taxation and Debt Management may know, recent changes in the U.S. tax law affecting U.S. workers overseas have raised the cost of having these individuals serve in foreign posts. The public record already indicates that it costs U.S. firms some $90,000 to maintain an American overseas in certain areas even though the salary at home would be $30,000 in comparable positions.

Moreover, in the Middle East, it is now often possible to hire two expatriates from another country for the same outlay as one similarly qualified U.S. citizen. Indeed, because other sovereign nations generally exclude their citizens' income earned abroad from taxation at home, such individuals in foreign service are often able--depending on local tax laws--to have sizable income boosts for serving abroad, whereas the U.S. workers they replace are only kept "whole" in the same circumstances. Americans are being priced out of foreign jobs because of myopic, extra-territorial U.S. tax policies that subject them to unusually high tax burdens as compared to foreign nationals.

Employers now must either "pick up the tab" or hire foreign nationals, and, if the employers are to remain competitive, they cannot normally employ U.S. citizens for twice the amounts payable to equally qualified foreign persons. Yet, in some instances, they have no practical choice, and stand to lose business that could give rise to U.S.-sourced manufacturing because of uncompetitive bids. A related consideration is that foreign nationals--particularly engineers--are more inclined to want to fill contract specifications with familiar equipment, which may not be of U.S. manufacture. To the extent that foreign-made goods are used for contracts of U.S.-based firms that have engaged foreign engineers, there is a U.S. domestic loss, however difficult it may be to quantify.

In our opinion, the burden of proof on "benefits" from tax provisions that hamper U.S. firms' ability to compete in world markets rests heavily on those who espouse such policies, including the peculiar, isolationist sections now in effect.

Other nations' approaches.--As to what our foreign trading partners do about this aspect of taxation, the Subcommittee might well take a look because U.S. policy is substantially out of phase.

According to GAO's 1978 report cited earlier, to give several examples, Canadian nonresident citizens are completely exempt from the Canadian income tax. Also, any citizen of the United Kingdom who spends 365 days working overseas is eligible for 100-percent tax relief, and U.K. persons who work abroad for more than 30 days qualify for partial relief. Similarly, Swedish citizens do not pay Swedish income tax if they are away from Sweden for more than one year. As Mr. Chafee remarked on introduction of his bill, S. 2283--

> Not one of our major competitors taxes the earned income of its citizens working abroad. Not only do we tax our expatriates, but we have imposed on them a system of taxation that is so complex it is impossible for any American overseas to fill out his own tax form. Only international tax specialists in a few major U.S. accounting firms are equipped to handle this onerous task.

The recent record.--Senator Chafee goes on to mention that, since mid-1978, U.S. exports to the Middle East have dropped from first place to twelfth place. He observes further that in the Middle East, the largest export market on earth, the U.S. share of construction contracts in that area in the 13-month period through June 1979 dropped to 1.6 percent from 10.3 percent in the period May 1975 to April 1978. We are not so naive as to think that the Section 911-913 misadventures alone were responsible for this abysmal decline, but they surely have been instrumental.

We might add that numerous responsible sources have estimated that huge amounts of business are being foregone because of the slavish U.S. adherence to a worldwide concept of taxing jurisdiction in this particular application. For example, GAO's report mentioned earlier indicated that U.S. tax policies affecting overseas workers could potentially reduce total U.S. exports by 5 percent or more. The President's Export Council's Subcommittee on Export Expansion has pointed out that this translates into approximately $7 billion of economic activity potentially or actually foregone, along with a job loss of 280,000.

To deal with this, the Export Council has offered the following recommendations, which we strongly endorse:

1. Regulations and interpretations in force under the current tax law concerning Americans living in camps in hardship areas (Section 911) should be simplified and made less restrictive, in keeping with the intent of Congress.

2. The current tax law concerning allowances to employees for excess living costs incurred while working abroad (Section 913) should be interpreted in the least restrictive and simplest manner.

3. Work should begin immediately to encourage enactment of a new tax law to put Americans working overseas on the same tax footing as citizens from competing industrial nations.

Tax Harmonization and Simplification

Harmonization.--We already have touched upon tax harmonization by noting that the U.S. tax policy in this area is isolationist and different from that pursued by other sovereigns. Although other nations generally observe principles of territorial jurisdiction, our government "reaches out" for worldwide income, with a limited foreign-tax-credit mechanism to help curtail some of the double taxation that inevitably results. The practical consequence of this is that Americans are able to serve abroad only if their employers can pay the tribute exacted by the Internal Revenue Service for the privilege of retaining citizenship while in foreign service.

As the Subcommittee is aware, tax harmonization has been an objective of most Administrations and is generally of interest to Congress too. If we are to have more international trading activity, including exports, U.S. tax policy makers must be cognizant of policies already in place abroad and endeavor to conform wherever that can be done consistent with the public interest. The U.K. provisions in this respect seem eminently sensible in providing total exclusions after 365 days abroad and partial exclusions after 30 days abroad. If Congress would revert to an exclusionary approach--even with a cap to foil peripatetic movie stars--it would advance the cause of harmonization in this part of the federal tax law.

We should repeat that international tax harmonization is not an objective by itself, but exists mainly to facilitate trade. The interface of national systems of taxation rarely are "neat," but seldom are they as misaligned as in the case of the U.S. Section 911-913 provisions vis-a-vis others. This country is paying a price in terms of employment and economic activity for our stubborn adherence to concepts not used elsewhere, and only Congress can rectify the situation. We should add that the tax treaty negotiating process simply is no answer to a problem of this magnitude. Until something is done to resolve the Section 911-913 dilemma, the costs will be incurred here and not elsewhere.

Revenue effects.--In that connection, we believe that the Treasury Department's revenue cost estimates associated with the foreign earned income exclusion in almost any feasible configuration may be suspect because they are unlikely to account fully for the beneficial effects of such an exclusion on the economy. The amounts are difficult to quantify, but at the same time, they should not be excluded from the tabulation. We would suggest to the Treasury Department and the staff of the Joint Committee on Taxation that they determine the "costs"--if any--in ranges based on differing assumptions about employment, economic activity, exports, "feedback" revenues, "ripple" effects, and the like. Further, the estimates of the Department of Commerce, as mentioned in the Report of the Export Council's Subcommittee should be taken into consideration.

Simplification.--Tax simplification is an announced goal of tax policy makers that too often is not achieved. The Section 911 exclusion that was in effect for so many years was easy to understand and administer, but it was scuttled because it conferred additional benefits in certain limited instances, and the overall constituency affected by the exclusion was too small to be heard above the din of those who perceived "inequity." Congress not only "fixed" some of the tax advantages, but also superimposed a framework of laws that created disincentives and could be administered only by specialists. We advised against such action, partly because of the complication that would result. Now, the complication we predicted exists, and the law therefore is under examination with a view to repeal.

In our opinion, a general, foreign-earned-income exclusion should be enacted to simplify the law in this area. The pre-1976 Act exclusion may not have scored "100" on equity, but it delivered rough justice in exchange for understandability and administrative ease. Also, as mentioned, some of the "inequity" grievances about the pre-1976 Act exclusion were eliminated before the unwieldly overlay of hardship-camp and excess-foreign-living-cost provisions was added. It seems to us that the time has come to get serious about tax simplification and to drop the "lip service." Congress has an opportunity to respond now in this one area to restore some perspective, and we urge that something be done.

The Bills

We commend Senators Bentsen, Chafee, and Jepsen for sponsoring proposed legislation that is significant and needed. On the other hand, we would rather not choose among the bills, because we are concerned mostly to have clear signs of progress in returning to a general exclusion and prefer not to quibble about details beyond matters stipulated below.

The main items.--Already in this letter, we have advocated a general exclusion, such as existed before the 1976 Act, with an increase to reflect inflation since the early 1960s. The exclusion must be "off-the-top"; the amount must be sufficiently high to accomplish the original purpose of the exclusion; and the residency requirements should be as lenient as possible, consistent with taxpayer fairness and with harmonization objectives previously discussed. Also, we would like to see elimination of all of the excess foreign living cost deductions that have turned this section of the tax law into a forbidding morass.

Residency requirement waiver.--Additionally, we feel that the legislation should waive the residency requirements where Treasury determines that American taxpayers have been required to leave a foreign country because of abnormal conditions precluding the normal conduct of business. We note in passing that legislation to accomplish this type of waiver for Iranian evacuees--and perhaps for others--has been approved by the House of Representatives and has been referred to the Senate Finance Committee. We urge prompt action on the measure, or, alternatively, on the broader waiver we have recommended for the foreign earned income exclusion bill.

Treasury attitudes.--We should mention our awareness of some Treasury Department concerns about the thinking we have advanced in this presentation because MAPI and many others consider them without merit. First, Treasury thinks that the connection between 911 and 913 and export activity is strained because an American worker overseas need not generate an export sale to earn the tax relief. We would remind Treasury that Section 911 was enacted almost 60 years ago as the "foreign trader exemption," and exports were as much behind the provision then as they are today. The collective wisdom of nearly 30 Congresses is not to be belittled, and, in our opinion, it would be highly impractical to tie exclusionary entitlement to export sales.

In order to fail to see the "connection" between the exclusion and U.S. exports, Treasury must disbelieve the substantial evidence that underlies the three bills before the Subcommittee, including the GAO Report discussed earlier./1 Our information indicates that American marketing and engineering personnel abroad, including senior level managers, do generate U.S. exports in more volume than their foreign counterparts. Also, we might add--although it is not wholly germane to the current discussion--permanent foreign manufacturing facilities abroad generate U.S. exports. Moreover, IRS benefits from successful international operations of U.S. firms whether they generate revenues stateside or abroad.

Further on exports particularly, we frankly do not feel that the President's Export Council would concern itself with Sections 911 and 913 if exports did not loom large in the picture. We suggest that Treasury read the output of this group, and satisfy itself that the recommendations and underlying rationale are correct.

We also have observed from recent interviews of Treasury personnel that the Department is not inalterably opposed to relief in this area, provided that the relief is financed by revenue-raising measures elsewhere such as by repeal of Domestic International Sales Corporation export incentives or by repeal or so-called "deferral" of

---

1/ We also refer Treasury and the Subcommittee to the recent study entitled, "Economic Impact of Changing Taxation of U.S. Workers Overseas," Chase Econometric Associates, Washington, D.C., June 1980, for additional corroboration of the need for relief.

taxes on unrepatriated income of controlled foreign corporations. This is tantamount to making a mistake (i.e., the current Section 911-913 arrangement) and then refusing to correct it unless permitted to make an offsetting error. We do not sympathize with this brand of logic, and we urge the Subcommittee to deal swiftly and summarily with those who espouse it. In the final analysis, they will benefit from the experience.

MAPI appreciates being able to present these thoughts to the Subcommittee.

Respectfully,

Charles Stewart

President

CWS:gm

NATIONAL COTTON COUNCIL OF AMERICA
POST OFFICE BOX 12285 / MEMPHIS, TENNESSEE 38112
TELEPHONE: (901) 274-9030

June 18, 1980

The Honorable Harry F. Byrd, Jr., Chairman
Subcommittee on Taxation and Debt Management
Senate Committee on Finance
2227 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

We have noted the contents of the three tax bills (S.2283, S.2418, and S.2321) mentioned in your press release of June 4, 1980 (Press Release #H-30).

We agree that Americans living and working abroad should pay income tax either to the United States or to the foreign country where they reside. However, we very firmly believe that they should not be penalized by double taxation.

If these Americans are required to pay income taxes to a foreign country, their payments to that country should be fully credited towards any income tax obligations that they have with the U. S. Federal Government and U. S. State Governments.

Furthermore, any housing allowance and/or cost-of-living allowance that they receive should be exempt from taxation either by the U. S. Federal Government or the U. S. State Governments.

In drafting the proposed new tax measures, we hope your Subcommittee will avoid double taxation and will not penalize Americans living and working abroad.

We respectfully request that this letter be included in the printed record of your hearing.

Sincerely,

Herman A. Propst

Herman A. Propst
President

HAP:fw

TWA
605 THIRD AVENUE, NEW YORK, NEW YORK, U.S.A. 10016

July 3, 1980

Mr. Michael Stern
Staff Director
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Stern:

Re: Statement in Support of Senate Bills S2283, S2321, S2418

There is little need to reiterate the statements and evidence which you have been presented with to show you that American business and the American economy have suffered due to the system of taxation which the U.S. employs with regard to its expatriates. It has been well documented, and I am certain that you are aware, that the U.S. is the only state of the major industrialized nations which taxes its citizens who work in foreign countries. This, of necessity, deters Americans from accepting overseas assignments or, in the alternative, increases the cost to the American employers who maintain tax protection programs. In either case, the system is counter productive and compounds the difficulty of American business in retaining an already precarious position in the international marketplace.

Therefore, we urge you to act and act promptly in consideration of the above noted bills in order that remedial action will not be delayed and so that American business can be helped to once again be restored to prominence and growth in international markets. Of course, it is not suggested that by passage of a relief provision for U.S. expatriates, that a cure all will have been found for American industry in the world of international business, but we believe and believe strongly, that the U.S. Government has an obligation to aid American business in its efforts to remain in a leadership position throughout the world, and the liberalization of the taxation of Americans working abroad will go a long way to improving the position of American business in this very competitive field of international business activities.

TRANS WORLD AIRLINES, INC.

Mr. Michael Stern
Page 2
July 3, 1980

Obviously, of the three bills being considered, Senator Chaffee's bill (S2321) which would eliminate U.S. taxation of foreign earnings of expatriates, would certainly be the most favorable of the remedial legislation which has been proposed and would also be similar to the methods used by most foreign nations in dealing with its citizens working abroad. Thus, it is the one bill which comes closest to putting Americans on an equal footing with some foreign competitors. For this reason, it is the bill we feel would best remedy the inequities of the U.S. tax system in dealing with the problem of U.S. companies losing their competitive position in the world, and we would support its passage.

Of course, the other two bills (S2283 and S2418), although not as favorable as Senator Chaffee's, will provide some help in correcting the problem created by the taxation of expatriates, and either would certainly be acceptable as an alternative to Senator Chaffee's remedy. However, there is no question but that complete exemption of foreign earnings for U.S. citizens assigned to overseas locations would provide a more complete answer.

Very truly yours,

B. G. Cappiello

Bernard G. Cappiello
Assistant Controller-
Tax Administration

Views of Republicans Abroad on Taxation of Income Earned Abroad by Americans Residing Abroad

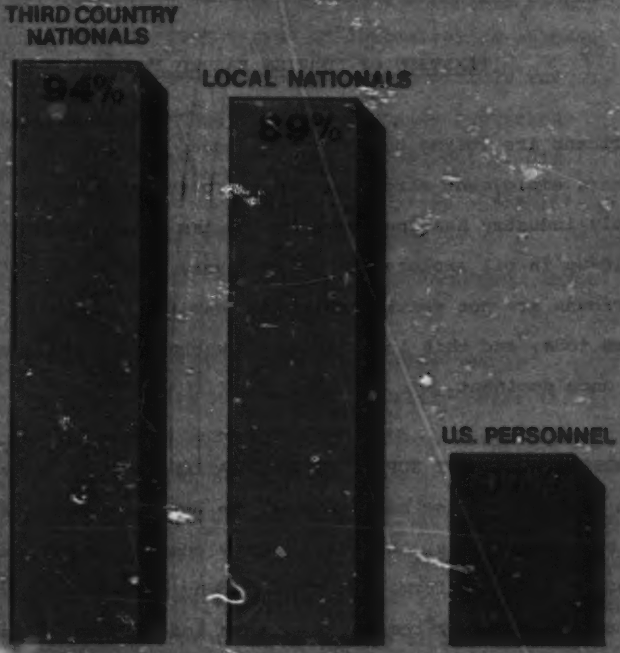
As the representative of Republicans Abroad in Washington, DC, we would like to go on record as supporting the bills presently before the Congress which advance the concept of reducing the unfair taxes on American citizens living and working abroad. These taxes, in their accumulation, have hamstrung the promotion of American interests abroad, especially in the export field, but also in those other fields of business enterprise undertaken by our citizens in foreign lands. The importance of the American community abroad, and its impact on the balance of payments, cannot be overestimated.

The fact that the United States is the only important country in the world which attempts to tax its nationals residing abroad on a regular and continuing basis for income earned abroad has had a harmful and deleterious effect on American interests. The stream of Americans returning from abroad, the loss of jobs to foreign nationals, the fall of our exports, the loss of contracts, will continue at an alarming rate if the income tax is allowed to remain at its high and punitive levels.

We favor no taxation of income earned abroad by bona fide Americans residing abroad. A removal of taxation will be a welcome relief from the present situation and one which will result in more jobs for Americans, stimulation to our exports abroad, greater wealth for our country, and once again make our products and our services competitive in the world market.

AMERICANS LOSING JOBS OVERSEAS

EMPLOYMENT INCREASES PETROLEUM EQUIPMENT / SERVICES INDUSTRIES 1975–1980



PETROLEUM EQUIPMENT SUPPLIERS ASSOCIATION
Suite 401 • 8226 Katy Freeway • Houston, Texas 77024

STATEMENT OF
PETROLEUM EQUIPMENT SUPPLIERS ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

TAXATION OF FOREIGN EARNED INCOME

Americans are losing out on jobs abroad. During the past 5 years employment abroad in the petroleum service - supply industry has increased due to the substantial build-up in oil exploration and recovery. However, Americans are not getting anywhere near their share of these jobs, and this in an industry where American expertise was once dominant.

PETROLEUM EQUIPMENT SUPPLIERS ASSOCIATION is an organization with 250 member companies in the petroleum service and supply business. A recent survey compiled by Price Waterhouse from information submitted by member firms revealed that U. S. companies in this industry increased their employees abroad by 85% between 1975 and 1980. Americans have been left behind in this increasing job market. U. S. expatriates abroad increased only 37% during the same period. Local nationals on the other hand have enjoyed an 89% increase in employment and third country nationals have doubled, with an increase of 94%.

Why are Americans losing out? Because of the high tax cost of sending Americans abroad. The tax cost of sending Americans abroad is high because:

1. The U. S. is the only major exporting country to tax its citizens on income earned abroad.
2. The Foreign Earned Income Act of 1978 was an improvement over the penalty provisions of the Tax Reform Act of 1976, but it did not go far enough in recognizing the extra cost incurred in living abroad.
3. The current system of taxing Americans abroad is extremely complicated.
4. The difficulty faced by expatriates in determining whether they qualify under the confusing and ambiguous definitions of the present tax act and the cost of its burdensome record keeping and substantiation requirements.
5. The housing deduction is not realistic since it is based on a percentage of artificially inflated taxable income.
6. The cost-of-living differential based on State Department classifications does not reflect actual costs faced by individuals

without government commissary and other assistance.

We strongly urge the Congress to reconsider the provisions covering the taxation of Americans working abroad. Full exclusion of income earned abroad as provided in Senator Jepsen's Bill, S.2321, would make U. S. expatriates more competitive with their counterparts from other nations. If abuse cannot be avoided under a system of unlimited exclusion, we recommend the flat exclusion approach under which an amount can be excluded which recognizes today's inflated price levels. Such alternative must also separately provide relief for the enormous housing costs now prevalent in many areas. S.2418, introduced by Senator Bentsen, recognizes this need and provides a simpler formula for the calculation of the amount of the foreign housing expense deduction. This bill also is more realistic in its residency requirements. The excess costs of working abroad begin on the first day an employee leaves this country. The 17 out of 18 month's requirement of the present Act and several of the pending bills now under consideration do not recognize this reality.

The enclosed Price Waterhouse report also presents a compilation of the average housing costs in various foreign locations. In many of these areas the cost of housing alone would absorb a large part of the flat exclusion, particularly in the case of those housing expenses which are greater than the average. In addition, rampant inflation in many locations has continued the upward surge of housing costs.

We cannot overemphasize the need for immediate relief. The disastrous trend of the last 5 years must be reversed. We must have more Americans in the foreign marketplace to sell and service American products. The last minute reprieves of the effects of the 1976 Act and the passage of the 1978 Act at the eleventh hour have contributed to the chaos and confusion American citizens face working abroad to sell and service U. S. products.

In this industry the compounding effects of the replacement of the Americans abroad will be felt for years to come. As Americans are replaced, citizens of other nations must be trained. This transfer of technology abroad through the training of foreign nationals is irreversible and further undermines our position of preeminence in the field of oil and gas technology.

Respectively submitted,

Carswell H. Cobb
Chairman, Tax Committee
Petroleum Equipment
Suppliers Association

July 3, 1980

Price
Waterhouse & Co.

1200 MILAM, SUITE 2700
HOUSTON, TEXAS 77002
713-654-4100

June 23, 1980

Petroleum Equipment Suppliers
 Association
9225 Katy Freeway, Suite 401
Houston, Texas 77024

Dear Sirs:

In accordance with your instructions, we have compiled the data furnished directly to us on a confidential basis by the companies listed in the accompanying Appendix. The information furnished by each company was prepared on the basis of instructions issued by you and has been summarized in conformity with those instructions.

Since we have not made any audit tests or other verification of the information submitted to us, we are unable to express an opinion on the information presented.

Yours very truly,

Price Waterhouse & Co.

PETROLEUM EQUIPMENT SUPPLIERS ASSOCIATION

INTERNATIONAL COMPENSATION SURVEY

1. Personnel employed abroad (Note A):

	1980	1975
United States personnel	1,503	1,094
Local nationals (Note B)	18,166	9,569
Third-country nationals (Note C)	1,770	913

2. Average costs for adequate housing for United States personnel in the following countries (Note D):

	1980	1975
Bahrain	$20,507	
Egypt	14,832	
England	14,615	$ 7,805
Gabon	20,547	16,740
Indonesia	17,719	14,824
Malaysia	14,000	12,106
Mexico	10,932	
Nigeria	27,765	16,000
Norway	11,800	7,680
Phillipines	12,405	
Saudi Arabia	25,978	
Singapore	14,497	
United Arab Emirates	16,741	12,000
Venezuela	19,828	

3. Current average base salary for United States personnel in the following countries (Note D):

	1980	1975
Bahrain	$30,400	
Egypt	27,984	
England	29,911	$14,472
Gabon	35,475	23,892
Indonesia	26,518	18,456
Malaysia	26,023	14,527
Mexico	31,320	
Nigeria	26,670	16,000
Norway	25,413	16,680
Phillipines	22,596	
Saudi Arabia	28,048	
Singapore	26,209	
United Arab Emirates	26,890	19,700
Venezuela	26,351	

NOTE A: Abroad is defined as outside the United States and Canada.

NOTE B: Local nationals are defined as citizens of the country in which they are employed.

NOTE C: Third-country nationals are defined as non-U.S. citizens who are not citizens of the country in which they are employed.

NOTE D: Average housing costs in 1975 and average base salaries in 1975 were furnished by Petroleum Equipment Suppliers Association.

APPENDIX

PETROLEUM EQUIPMENT SUPPLIERS ASSOCIATION

INTERNATIONAL COMPENSATION SURVEY

ALPHABETICAL LIST OF PARTICIPANTS IN SURVEY

A-1 Bit & Tool Company
Axelson, Inc.
Baker International
Baker Packers
Baker Sand Control
Branham Industries, Inc.
Byron Jackson Pump Division
Camco, Incorporated
C-E Vetco Services, Inc.
Centrilift, Inc.
Christensen, Inc.
Dresser Industries
Dresser Oilfield Equipment Group
Drilco
Galveston-Houston Co.
Grant Corporation
Halliburton Services
Hughes Tool Company
Hydril Company
Hydro Tech International, Inc.
McEvoy
Mid-Continent Supply Co.
National Supply Company
NL Atlas Bradford
NL Baroid
Regan Offshore International, Inc.
Sii Drilco
Sii Dyna-Drill
Sperry-Sun International, Inc.
TRW-Reda Pump Division
TRW-Subsea
Vetco Offshore, Inc.
Weatherford International, Inc.
Western Oceanic, Inc.
Wilson International
W-K-M Division, ACF Industries Inc.

SPECIAL COMMITTEE FOR U.S. EXPORTS

[redacted]
1101 Connecticut Avenue, Suite 700
Washington, D.C. 20036
202/857-1190

Chairman, David C. Garfield, Vice Chairman, Ingersoll-Rand Company
Vice Chairman (Aerospace & Transportation), Robert T. Campion, President and Chairman, Lear Siegler, Inc.
Vice Chairman (Agriculture), Edward W. Cook, Chairman and Chief Executive Officer, Cook Industries, Inc.
Vice Chairman (Automotive Equipment), E. Mandell de Windt, Chairman of the Board, Eaton Corporation
Vice Chairman (Chemicals), Vincent L. Gregory, Jr., President and Chief Executive Officer, Rohm and Haas Company
Vice Chairman (Construction Products), James A. Miller, Chairman and Chief Executive Officer, Porter, Inc.
Vice Chairman (Control Instrumentation), Earle W. Pitt, President and Chief Executive Officer, Foxboro Company
Vice Chairman (Electrical Machinery), Charles F. Knight, Chairman and Chief Executive Officer, Emerson Electric Company
Vice Chairman (General Machinery), J.A.D. Geier, President and Chief Executive Officer, Cincinnati Milacron Inc.
Vice Chairman (Health Products), Karl D. Bays, Chairman and Chief Executive Officer, American Hospital Supply Corporation
Vice Chairman (Metal Fabricators), Robert H. Malott, Chairman and President, FMC Corporation
Vice Chairman (Specialty Products), Phil F. Sorensen, President, Sorensen [illegible] Company
Treasurer, Francis G. Addison, III, Chairman and Chief Executive Officer, Union First National Bank of Washington

S.2757

To Encourage Exports and the Expansion of Export Trade Services by Providing for Special Provisions on Taxation of Export Trading Companies

Testimony

Presented to

The Senate Finance Subcommittee

On Taxation and Debt Management Generally

June 24, 1980

Submitted on Behalf of the

Special Committee for U.S. Exports

By

John R. Babson
Chairman Executive and Steering Committees
Special Committee for U.S. Exports
and
Vice President

Mr. Chairman, Members of the Committee:

My name is John R. Babson, I am Chairman of the Executive and Steering Committees of the Special Committee for U. S. Exports and Vice President of Ingersoll-Rand Company. My testimony is on behalf of the Special Committee.

The Special Committee is a participating group of more than 1,200 business concerns and 80 supporting business associations whose operations and concerns are directed to the export of U.S. products. The Special Committee's major concerns are with the effect of the U.S. tax system on exports by U.S. businesses and the ability of those businesses to compete in foreign trade in view of the many tax advantages and incentives and direct and indirect subsidies provided to foreign competitors by their governments.

In General

The concerns of the Special Committee are set forth in the remarks of Ambassador Reubin Askew, United States Trade Representative, on June 10, 1980 (attached as Exhibit A):

> There may have been a time when the United States of America could, without question and without challenge, dominate the world economy. But no more.
>
> There may have been a time when we could simply assume in America that our high standard of living would grow higher and higher. But not any more.

There may have been a time when we could afford in America merely to react to economic issues as they arose and address them separately and without regard to their crucial interrelationships. But no more.

For several years we have been faced with international trade deficits, declining productivity and inadequate capital formation. This has lead to devaluation of the dollar -- inflation -- restrictive monetary controls -- recession and deficit spending. Looking at our international trade position over the last decade as a major factor, our present economic position is the expected result.

There has been a great deal of discussion of the need for increasing exports over the last several years. It is widely recognized that there are a number of areas where encouragement and incentives for U.S. exports will produce results. However, the preponderance of governmental action has reduced not increased exports. Examples of governmental action in recent years have been the enactment of confusing, often conflicting and cumbersome boycott and foreign corrupt practice provisions. In addition, many U. S. laws in environmental and other areas have been applied to exports in a restrictive fashion. Moreover, private sector trade restrictions, unrelated to national security interest, have been used in foreign policy.

The time has come when we must quit enacting laws and promulgating regulations which hinder our ability to export. Needless laws and regulations should be eliminated and others should be simplified.

In the longer run it is necessary to address the question of comparability of tax treatment of American firms relative to foreign firms engaged in foreign exports. Overseas manufacturing companies engaged in trade are relieved of the burden of indirect taxes on foreign source income and a number of other taxes which apply to American firms engaged in exporting. We urge that the Commmttee undertake a longer range program to reduce this disparity in taxes which favors foreign competitors over U. S. exporters. We call to your attention the conclusion of the trade negotiations in Geneva and the Congressional Reports on the MTN legislation which called for an international conference on taxes as they affect trade. The work of this Committee could be very useful in seeking a suitable American initiative in this respect.

S.2757

S.2757 is taken from Title III of the Export Trading Companies Act of 1980 (S.2718). S.2718 is intended to encourage exports by facilitating the formation and operation of export trading companies, export trade associations, and the expansion of export trade services generally.

The tax provisions in S.2757 make three amendments consistent with the export trading companies provisions. These amendments amend the Internal Revenue Code to:

1. permit bank investments in export trading companies without disqualifying them from status as a Domestic International Sales Corporation (DISC),

2. make receipts from exports of services or export trade services eligible export receipts for DISC, and

3. permit certain export trading companies to qualify as Subchapter S corporations (closely held corporations with 15 or fewer shareholders which are taxed in a manner similar to a partnership).

Another important provision requires the Secretary of Commerce in consultation with the Secretary of the Treasury to prepare and distribute information on how export trading companies could use DISC.

Enactment of the export trading company provisions would be a positive step toward the necessary revitalization of U.S. exports. It would be of particilar benefit to small and medium sized companies which are presently not exporting due to the cost and complexities of entering foreign markets. In addition, incentives would be provided for increasing export services.

We feel that this legislation is good for exports in that it demonstrates a changing and more favorable export trade policy for this country. However, enactment of this legislation will have a limited impact at best on our trade posture over the short run. Further, it is not comparable to nor competitive with the export programs or export trading companies of other nations, such as Japan. Thus, it is only a beginning towards a more realistic export policy.

Other Tax Incentives

There are a number of other changes which should be considered. In the area of tax incentives, DISC is the only U.S. tax incentive to offset the myriad of foreign incentives. DISC should be simplified, strengthened and made more effective.

In the area of small companies, the qualification and reporting requirements for a DISC should be simplified. For a more detailed explanation see Exhibit B. In addition, DISC could be made more effective by increasing the small DISC exemption from the incremental growth in sales rules and by extending DISC to cover smaller companies not directly involved in exporting but supplying parts and components used in exports.

Any program for exports must recognize that 85 percent of U.S. manufactured exports are exported by 1900 U.S. companies.

These companies are faced with extreme competition from equally large and often larger companies which receive many export incentives from their governments. Overall, DISC can be made more effective by returning to 100 percent deferral (originally proposed) for DISCs, eliminating the incremental requirements or freezing the incremental base period at present levels.

Another important step would be for the Commerce and Treasury Departments to use DISC as a tool for encouraging exports. The effectiveness of DISC has been reduced by the negative statements and attitude of the Administration over the last several years. The problem is illustrated in the attached Exhibit C containing comments of H. David Rosenbloom, International Tax Counsel, Treasury. Mr. Rosenbloom is quoted as referring to DISC as an "excrescence" and an "unnatural growth" on our tax laws.

This uncertainty with respect to the DISC program is magnified throughout our export policy. A major step would be for the government to provide private industry with rules and policies which can be easily understood and relied on by businesses engaged in international commerce.

Conclusion

In summary, the need for new and imaginative initiatives in the export area is apparent. The time has come to quit talking about our international trade problems and take constructive action. Enactment of S.2757 will encourage and enhance the ability of some businesses to export. More important, it is a step toward a realistic export policy.

Thank you.

EXHIBIT "A"

REMARKS OF
AMBASSADOR REUBIN O'D. ASKEW
UNITED STATES
TRADE REPRESENTATIVE

TO THE
NATIONAL PRESS CLUB

WASHINGTON, D.C.
JUNE 10, 1980

THE 1980'S WILL NOT BE THE 1950'S.

THERE MAY HAVE BEEN A TIME WHEN THE UNITED STATES OF AMERICA COULD, WITHOUT QUESTION AND WITHOUT CHALLENGE, DOMINATE THE WORLD ECONOMY. BUT NO MORE.

THERE MAY HAVE BEEN A TIME WHEN WE COULD SIMPLY ASSUME IN AMERICA THAT OUR HIGH STANDARD OF LIVING WOULD GROW HIGHER AND HIGHER. BUT NO MORE.

THERE MAY HAVE BEEN A TIME WHEN WE COULD AFFORD IN AMERICA MERELY TO REACT TO ECONOMIC ISSUES AS THEY AROSE AND ADDRESS THEM SEPARATELY AND WITHOUT REGARD TO THEIR CRUCIAL INTERRELATIONSHIPS. BUT NO MORE.

THE WORLD HAS CHANGED. AND AMERICA MUST CHANGE AS WELL. WE MUST -- AS PRESIDENT CARTER HAS SAID -- SEE THE WORLD AS IT IS, WITHOUT ILLUSIONS AND WITHOUT UNREALISTIC EXPECTATIONS. AND WE MUST RESPOND ACCORDINGLY.

AS I SEE IT, THE AMERICAN ECONOMY BECAME STRONG IN THE FIRST PLACE BECAUSE WE HAD SEVERAL INITIAL ADVANTAGES. WE WERE BLESSED, FIRST OF ALL, WITH A SEEMINGLY ENDLESS GOD-GIVEN SUPPLY OF CHEAP ENERGY AND OTHER NATURAL RESOURCES. WE ENJOYED AS WELL A VIRTUALLY UNLIMITED AND EVER-EXPANDING DOMESTIC MARKET WHICH MADE FOREIGN MARKETS SEEM OF MINIMAL IMPORTANCE TO OUR OVERALL WELFARE AS A NATION. WE WERE ABLE TO COMPETE EFFECTIVELY, WHEN WE WISHED, IN FOREIGN MARKETS BECAUSE COMPETITION ABROAD GENERALLY WAS NOT REALLY FIERCE. AND, MOST OF ALL, WE PROFITED FROM THE INCENTIVES AND THE INNOVATIONS OF A HUMANISTIC SYSTEM OF FREE ENTERPRISE.

THESE WERE THE ADVANTAGES WHICH ENABLED US TO PROVE KARL MARX A LIAR BY COMBINING THE BEST ELEMENTS OF DEMOCRACY AND CAPITALISM AND REAPING THE BENEFITS OF BOTH. THESE WERE THE SOURCES OF THE LOFTY STANDARD OF LIVING WHICH MADE US FOR SO LONG THE ENVY OF THE WORLD.

BUT NOW THERE IS NO MORE CHEAP ENERGY. THERE ARE NO MORE NATURAL RESOURCES IN LIMITLESS ABUNDANCE. THERE ARE NO MORE ASSURED MARKETS, EITHER AT HOME OR ABROAD. AND THE FREE ENTERPRISE SYSTEM WHICH HAS SERVED US SO WELL IS BURDENED INCREASINGLY BY EXCESSIVE REGULATION DOMESTICALLY AND BY TRADE DISTORTIONS SUCH AS CARTELS AND GOVERNMENTAL SUBSIDIES INTERNATIONALLY WHICH KEEP IT FROM FUNCTIONING AS IT SHOULD.

AMERICA IS AT BAY IN AN INCREASINGLY COMPETITIVE AND INCREASINGLY DIFFICULT WORLD. OUR TRADITIONAL POSITION OF LEADERSHIP IN THE WORLD MARKETPLACE IS IN JEOPARDY. SO TOO IS THE DOMESTIC INDUSTRIAL BASE WHICH MADE AMERICAN LEADERSHIP IN THE WORLD POSSIBLE IN THE FIRST PLACE. AS UNITED STATES TRADE REPRESENTATIVE, I SEE EVIDENCE OF THIS FIRSTHAND EVERY DAY.

THE WORLD IS BECOMING MORE AND MORE FRAGMENTED AS MORE AND MORE NATIONS DEVELOP ECONOMICALLY. THIS PROCESS IS COMPLICATED BY THE APPROACHING END OF THE PETROLEUM AGE AS WORLDWIDE RESERVES OF COMMERCIALLY RECOVERABLE OIL CONTINUE TO DECLINE. HERE IN THE UNITED STATES, OUR EFFORTS TO CONFRONT THESE NEW REALITIES HAVE CRUEL AND VARIED EFFECTS ON OUR ECONOMY.

ALL THESE EFFECTS, I AM PERSUADED, MUST BE VIEWED AS A WHOLE. THEY ARE ALL PIECES OF THE SAME PUZZLE. YET THE ALL TOO NARROW FOCUS OF BOTH PUBLIC DEBATE AND GOVERNMENTAL DECISIONMAKING SEEMS INCLINED, ALL TOO OFTEN, TO DEAL WITH THE PIECES, AND NOT THE PUZZLE.

THE MOST OBVIOUS, AND SURELY THE MOST REVEALING, OF THE PIECES TO OUR ECONOMIC PUZZLE IS THAT OF INCREASING FOREIGN COMPETITION FOR SALES WITHIN OUR OWN DOMESTIC MARKET. WITH AUTOS, WITH STEEL, WITH TEXTILES, WITH SHOES, AND WITH COUNTLESS OTHER GOODS AND COMMODITIES -- WE ARE FACING STIFF COMPETITION FROM FOREIGN PRODUCERS. WE SEE THE CONSEQUENCES OF THIS COMPETITION IN OUR UNEMPLOYMENT LINES.

SOME SUGGEST THAT THE BEST WAY TO CONFRONT THIS GROWING COMPETITION FROM FOREIGN NATIONS IS TO ELIMINATE IT. THEY WOULD HAVE US BUILD A HIGH WALL AROUND AMERICA IN THE FORM OF NEW TARIFFS AND NON-TARIFF BARRIERS TO TRADE. THEY WOULD HAVE US INSULATE OURSELVES FROM THE THREAT OF COMPETITION FROM ABROAD AND FROM THE UNCOMFORTABLE FACT OF OUR OWN LACK OF COMMERCIAL COMPETITIVENESS.

THESE SUGGESTIONS ARE UNDERSTANDABLE BUT SELF-DEFEATING. IF USED AS A CRUTCH AGAINST LEGITIMATE COMPETITION, PROTECTIONISM WOULD SHIELD AND PROLONG INEFFICIENT PRODUCTION, INCREASE INFLATION, DECREASE OUR STANDARD OF LIVING, AND GENERALLY CAUSE US TO CONTINUE OUR DESCENT INTO A LESS COMPETITIVE POSITION INTERNATIONALLY. MOREOVER, A HEADLONG RUSH INTO PROTECTIONISM WOULD RISK RECREATING THE ECONOMIC CHAOS OF THE 1930'S. PROTECTIONIST MEASURES BY AMERICA WOULD ONLY BE ANSWERED BY PROTECTIONIST MEASURES ABROAD.

THIS IS A LESSON WE SHOULD HAVE LEARNED FIFTY YEARS AGO IN THE DEPTHS OF THE GREAT DEPRESSION. WHATEVER OUR PROBLEMS IN AMERICA, THEY CANNOT BE SOLVED BY A RETURN TO THE DARK DAYS OF THE SMOOT-HAWLEY APPROACH. WE CANNOT, LIKE OSTRICHES, HIDE OUR HEADS IN THE SAND OF OUR OWN SHORTCOMINGS, AND EXPECT, THEREBY, TO BE RID OF THEM.

WE MUST, OF COURSE, ACKNOWLEDGE THE LEGITIMACY OF SOME DEMANDS FOR RELIEF FROM IMPORT COMPETITION. WHERE AMERICAN PRODUCERS ARE BEING INJURED BY THE UNFAIR TRADE PRACTICES OF OTHER NATIONS, SUCH AS BY FOREIGN DUMPING OR BY SUBSIDIZED GOODS, RELIEF IS PLAINLY ESSENTIAL AND, INDEED, IS REQUIRED BY LAW. AND -- MAKE NO MISTAKE ABOUT IT -- IN SUCH INSTANCES, OUR FIRM POLICY IN THE CARTER ADMINISTRATION IS TO PROVIDE THE NEEDED RELIEF.

FURTHERMORE, WHERE RELIEF FOR A LIMITED PERIOD OF TIME CAN HELP AN AMERICAN PRODUCER SURVIVE AN INJURY OR A THREAT OF INJURY DUE TO SUDDEN IMPORT SURGES, AND WHERE THAT PRODUCER DEMONSTRATES AN INTENT TO USE ANY GRANTED RELIEF PERIOD CONSTRUCTIVELY TO BECOME MORE COMPETITIVE, SOME ACCOMMODATION MAY ALSO BE IN ORDER.

BUT EVERY REQUEST FOR DISCRETIONARY RELIEF MUST BE VIEWED WITH AN AWARENESS OF THE OVERALL IMPACT OF GRANTING SUCH RELIEF. AND, EXCEPT WHEN RELIEF IS CLEARLY JUSTIFIED AND APPROPRIATE, SUCH REQUESTS MUST BE DENIED. THIS MUST BE OUR POLICY, NOT BECAUSE WE ARE UNCONCERNED ABOUT THE WELFARE OF AMERICAN JOBS OR AMERICAN INDUSTRY, BUT BECAUSE WE ARE CONCERNED, AND BECAUSE WE KNOW THAT WE CANNOT AND MUST NOT ISOLATE OURSELVES FROM THE ECONOMIC REALITIES OF THE WORLD IF WE HOPE TO CREATE NEW JOBS AND NEW INDUSTRIES.

INSTEAD, WE MUST ACCEPT THOSE REALITIES, AS PAINFUL AS THEY MAY BE, AND ADJUST TO THEM AS BEST WE CAN. OUR PRESENT POLICY OF NOT SEEKING RESTRICTIONS ON IMPORTS OF JAPANESE AUTOMOBILES INTO THE UNITED STATES IS TANGIBLE EVIDENCE, NOT ONLY OF PRESIDENT CARTER'S CONSIDERABLE POLITICAL COURAGE, BUT ALSO OF HIS COMMITMENT, AND THAT OF HIS ADMINISTRATION, TO ADJUST TO COMPETITIVE ECONOMIC CONDITIONS AS WE SHOULD. THE PRESIDENT KNOWS, AS DO MANY WHO ARE CONNECTED WITH THE AUTO INDUSTRY AND WITH OTHER INDUSTRIES AFFECTED BY INCREASING IMPORTS, THAT, CLEARLY, THE LONG-RANGE INTEREST OF THIS NATION LIES, NOT IN PROTECTIONISM, BUT IN ACHIEVING FREER WORLD TRADE ON FAIRER TERMS.

THE PRESIDENT REMAINS SENSITIVE TO THE SERIOUSNESS OF THE PLIGHT OF THE AUTO INDUSTRY. AND, OF COURSE, WE ARE CONTINUING TO MONITOR THIS SITUATION CLOSELY, PARTICULARLY IN VIEW OF THE POSSIBILITY OF A FORMAL REQUEST FOR RELIEF. BUT WE ALSO KNOW THAT, AS A RULE AND AS A MATTER OF CONSCIOUS POLICY, WE SHOULD BE STRIVING TO OPEN MARKETS AROUND THE WORLD, NOT TO CLOSE THEM. AND WE SHOULD BE PREPARING TO TAKE ADVANTAGE OF THE MARKETS WE OPEN.

THAT IS PRECISELY WHAT OUR EFFORTS IN THE TOKYO ROUND OF MULTILATERAL TRADE NEGOTIATIONS WERE ALL ABOUT. HERE AGAIN, THE COURAGE AND THE PERSEVERANCE OF JIMMY CARTER, TOGETHER WITH THE CONSIDERABLE SKILL OF AMERICAN NEGOTIATORS SUCH AS MY PREDECESSOR, BOB STRAUSS, MADE POSSIBLE THE SUCCESSFUL COMPLETION OF NEGOTIATIONS VIRTUALLY EVERYONE ELSE HAD THOUGHT WERE DOOMED TO FAILURE.

THE TRADE AGREEMENTS OF THE TOKYO ROUND HAVE DONE MUCH TO IMPROVE THE WORLD TRADING SYSTEM. THEY LOWER TARIFFS AND ESTABLISH NEW GROUND RULES FOR LIMITING NON-TARIFF BARRIERS TO TRADE. THEY GIVE US AN OPPORTUNITY TO DEVELOP THE GENERAL AGREEMENT ON TARIFFS AND TRADE -- THE GATT IN GENEVA -- INTO THE GENUINE INTERNATIONAL TRADE ORGANIZATION THE WORLD HAS LONG NEEDED -- AN INSTITUTION BY DESIGN AND NOT BY DEFAULT. MOST OF ALL, THE NEW TRADE AGREEMENTS PROVIDE US WITH A FOUNDATION FOR FURTHER EXPANSION OF TRADE WORLDWIDE -- A FOUNDATION WE VERY MUCH NEED AT A TIME WHEN THE WORLD IS RIFE WITH RENEWED CALLS FOR PROTECTIONISM AS AN ANTIDOTE TO ECONOMIC ANGUISH.

AMERICA HAS ALWAYS PROFITED FROM THE EXPANSION OF WORLD TRADE. THE TRADE LIBERALIZATION OF THE KENNEDY ROUND CONTRIBUTED IMPORTANTLY TO THE ECONOMIC GROWTH OF THE EARLY 1960'S. WHATEVER OUR CURRENT DIFFICULTIES, WE STILL HAVE THE SIZE, THE SKILLS, AND THE RESOURCES TO BE SUCCESSFUL TRADERS. BUT IN ORDER TO CAPITALIZE ON OUR TRADING OPPORTUNITIES AS WE SHOULD, WE MUST BEGIN TO THINK OF OURSELVES AS A TRADING NATION.

THIS IS SOMETHING THE AVERAGE AMERICAN CITIZEN MUST COME TO UNDERSTAND. ANY INCREASE IN OUR NATIONAL STANDARD OF LIVING WILL REQUIRE AN INCREASE IN OUR ECONOMIC GROWTH. AND ONE OF THE GREATEST OPPORTUNITIES WE HAVE TO ACHIEVE ECONOMIC GROWTH IS THROUGH A CONTINUED INCREASE IN OUR EXPORTS OF GOODS AND SERVICES TO OTHER NATIONS.

INCREASED EXPORTS ARE CRITICAL TO FULL ECONOMIC RECOVERY FOR AMERICA. THEY ARE ESSENTIAL TO THE STABILITY OF THE DOLLAR. THEY ARE CRUCIAL TO OUR EFFORTS TO REDUCE OUR SUBSTANTIAL TRADE DEFICIT AND HELP PAY FOR IMPORTED OIL AND OTHER PRODUCTS WHICH THE AMERICAN ECONOMY DEMANDS AND AMERICAN CONSUMERS DESIRE.

THE CONTRIBUTION OF FOREIGN TRADE TO OUR GROSS NATIONAL PRODUCT HAS BEEN INCREASING STEADILY. WE CAN EXPECT TRADE TO CONTINUE INCREASING IN IMPORTANCE TO AMERICA AS OUR SHRINKING WORLD BECOMES MORE AND MORE INTERDEPENDENT. YET, INCREASINGLY, AMERICAN COMPANIES ARE LOSING IN THE COMPETITION FOR WORLD TRADE. THE AMERICAN SHARE OF OVERALL FREE WORLD TRADE HAS DECLINED SIGNIFICANTLY.

TO A CERTAIN EXTENT, THIS IS UNDERSTANDABLE. THE DOMINANCE AMERICA ENJOYED IN THE WORLD ECONOMY IN THE UNNATURAL CONDITIONS WHICH PREVAILED AFTER WORLD WAR II SHOULD NOT HAVE BEEN EXPECTED TO LAST FOR VERY LONG. OUR OWN ENLIGHTENED EFFORTS TO REBUILD THE ECONOMIES OF EUROPE AND JAPAN AS BULWARKS AGAINST COMMUNISM ENSURED THAT AMERICA'S ECONOMIC PREEMINENCE WOULD EVENTUALLY BE CHALLENGED. AT THE SAME TIME, THE NATIONS OF THE THIRD WORLD HAVE EMERGED FROM COLONIALISM INTO INDUSTRIALISM AND ARE BEGINNING TO ASSUME THEIR RIGHTFUL PLACES IN THE WORLD ECONOMY. AND WE ALL KNOW ONLY TOO WELL OF THE NEWFOUND MIGHT OF THE OIL-PRODUCING NATIONS WHICH ASSERT SO MUCH INFLUENCE OVER AMERICA BECAUSE OF OUR EXCESSIVE DEPENDENCE ON FOREIGN OIL.

THE REAL QUESTION IS NOT WHETHER WE CAN REESTABLISH OUR LOST DOMINANCE. WE CANNOT. THE QUESTION IS WHETHER WE CAN ADJUST TO THE CHANGED CIRCUMSTANCES IN WHICH WE FIND OURSELVES IN ORDER TO ASSURE A CONTINUED ROLE OF MAJOR SIGNIFICANCE FOR AMERICA IN THE SHIFTING WORLD ECONOMY AND A CONTINUED PROSPERITY FOR OUR PEOPLE HERE AT HOME.

WITHOUT THIS ROLE, AND WITHOUT THIS PROSPERITY, WE WILL BE UNABLE TO ASSERT THE LEADERSHIP NECESSARY NOT ONLY TO STRENGTHEN THE WORLD TRADING SYSTEM, BUT ALSO TO SUSTAIN THE WORLDWIDE STRUGGLE FOR FREEDOM. FOR THE STRUGGLE FOR FREEDOM IS INSEPARABLE FROM THE WORLDWIDE ASSERTION OF LEGITIMATE ECONOMIC ASPIRATIONS. AND THEREIN LIES THE INCREASING IMPORTANCE OF TRADE TO THIS NATION.

FOR THE SIMPLE TRUTH IS THAT, IN MANY INSTANCES, WE ARE BEING BEATEN FAIR AND SQUARE BY OUR GROWING ARRAY OF COMPETITORS. IN PART, THIS CAN BE ATTRIBUTED TO THE SHORTCOMINGS OF AMERICAN BUSINESS. WE NEED BETTER MARKET PENETRATION. WE NEED TO DESIGN MORE GOODS SPECIFICALLY FOR FOREIGN MARKETS. AND WE NEED TO BE MORE RESPONSIVE TO DEMANDS WITHIN OUR OWN DOMESTIC MARKET SO THAT BUYERS HERE AT HOME WILL HAVE LESS REASON TO LOOK ELSEWHERE TO SATISFY THEIR NEEDS. AS IT IS, EVEN AMERICAN CONSUMERS ARE BUYING MORE AND MORE GOODS AND COMMODITIES FROM OTHER NATIONS -- BECAUSE THEY ARE CHEAPER AND BECAUSE MANY OF THEM SEEM TO BE OF BETTER QUALITY THAN THOSE WE PRODUCE IN THE UNITED STATES.

BUT OUR GOVERNMENT IS ALSO TO BLAME FOR OUR CONTINUED DECLINE AS A COMPETITOR IN THE WORLD ECONOMY. TOO OFTEN IN GOVERNMENT WE HAVE SIMPLY ASSUMED THAT AMERICAN COMMERCE WOULD CONTINUE TO FLOURISH, REGARDLESS OF GOVERNMENTAL DECISIONS. TOO OFTEN WE HAVE BEEN WILLING TO SACRIFICE THE COMMERCIAL INTEREST OF AMERICA FOR THE SAKE OF VARIOUS POLITICAL INTERESTS. TOO OFTEN WE HAVE HANDCUFFED AMERICAN BUSINESS BY CREATING AND IMPOSING NEEDLESS IMPEDIMENTS TO EXPORTS. AND, TOO OFTEN, WE HAVE OVERLOOKED THE IMPORTANCE OF PRESERVING A STRONG INDUSTRIAL BASE FOR AMERICA.

CERTAINLY WE MUST CONTINUE TO FULFILL OUR COMMITMENTS TO OTHER TRADING NATIONS. BUT IT IS TIME NOW FOR US NOT ONLY TO FULFILL OUR COMMITMENTS, BUT ALSO TO ASSERT OUR RIGHTS. WE MUST DEMAND FROM OTHER NATIONS THE SAME STRICT ADHERENCE TO THE INTERNATIONAL RULES OF TRADE THAT THEY EXPECT OF US. THIS, I WANT TO EMPHASIZE, IS THE FIRM POLICY OF THIS ADMINISTRATION.

AT THE SAME TIME, WE MUST FREE AMERICAN BUSINESS TO COMPETE ON MORE EVEN TERMS IN THE WORLD MARKETPLACE. THIS WILL REQUIRE THE REMOVAL OR REVISION OF ALL GOVERNMENTAL ACTIONS AND POLICIES WHICH RESULT IN NEEDLESS EXPORT DISINCENTIVES. WE CAN NO LONGER CONSIDER THESE VARIOUS DISINCENTIVES IN A VACUUM. IN EACH INSTANCE, WE MUST CONSIDER THEIR FULL IMPLICATIONS FOR TRADE AND FOR OUR NATIONAL ECONOMY AND, THUS, FOR OUR STANDARD OF LIVING. ONLY THEN WILL WE APPRECIATE FULLY THE URGENCY OF OUR TASK.

FOR EXAMPLE, WE MUST CHANGE THE WAY WE TAX AMERICANS LIVING AND WORKING ABROAD. WE MUST CLARIFY THE FOREIGN CORRUPT PRACTICES ACT TO MAKE IT ENFORCEABLE AND TO ELIMINATE NEEDLESS UNCERTAINTIES AND ANXIETIES WHICH INHIBIT TRADE AND COMPLICATE TRADE AND INVESTMENT DECISIONS. AND WE MAY ALSO NEED TO CHANGE SOME OF OUR ANTITRUST POLICIES. FOR OTHER NATIONS VIEW AS PRESUMPTUOUS OUR EFFORTS TO IMPOSE OUR LAWS AND OUR PRIORITIES OUTSIDE OUR NATIONAL BORDERS. IT IS ONE THING TO LEAD BY EXAMPLE. IT IS QUITE ANOTHER TO TRY TO DICTATE OUR VIEWS TO OTHERS.

IN RESPONSE TO A CONGRESSIONAL MANDATE, WE ARE NOW CONDUCTING -- WITH THE FULL AND ACTIVE PARTICIPATION OF BUSINESS AND LABOR -- A FULL REVIEW OF THESE AND OTHER EXPORT DISINCENTIVES WITHIN THE ADMINISTRATION. THE PRESIDENT HAS SOUGHT A BROAD RANGE OF ADVICE IN PREPARING THE REPORT HE WILL SUBMIT TO CONGRESS NEXT MONTH. MY HOPE IS THAT THIS REPORT

IN ADDITION TO REMOVING NEEDLESS EXPORT DISINCENTIVES, WE MUST GIVE ADDED STRENGTH TO THE NATIONAL EXPORT POLICY PRESIDENT CARTER HAS ALREADY ANNOUNCED. THIS MEANS BROADENING THE COVERAGE OF THE WEBB-POMERENE ACT. IT MEANS GREATER FINANCIAL SUPPORT FOR THE EXPORT-IMPORT BANK. IT MEANS INCREASED RELIANCE ON THE OVERSEAS PRIVATE INVESTMENT CORPORATION AS AN INSTRUMENT FOR FACILITATING INVESTMENT. IT MEANS IMPROVING THE CLIMATE FOR INCREASED AMERICAN INVESTMENT ABROAD. AND IT MEANS THE ENACTMENT OF LEGISLATION ALLOWING THE CREATION OF EXPORT TRADING COMPANIES TO HELP SMALL AND MEDIUM-SIZED BUSINESSES BEGIN EXPORTING AS THEY SHOULD.

BUT EVEN ALL THESE EFFORTS, I AM CONVINCED, WILL NOT BE ENOUGH. IT WILL NOT BE SUFFICIENT TO PROMOTE EXPORTS IF THE EXPORTS WE PROMOTE ARE NOT COMPETITIVE WITH THOSE OF OTHER NATIONS. NOR WILL WE BE SUCCESSFUL IN SECURING STABLE AND GROWING EXPORT MARKETS IF WE DO NOT HAVE A GREATER MEASURE OF STABILITY AND GROWTH IN OUR DOMESTIC ECONOMY.

WHATEVER ELSE WE DO, WE MUST ADDRESS THE REAL ROOT CAUSE OF MUCH OF OUR NATIONAL DISTRESS -- WHICH IS THE GRADUAL BUT UNMISTAKABLE EROSION OF AMERICA'S VITAL INDUSTRIAL BASE. A STRONG INDUSTRIAL BASE IS ESSENTIAL TO THE REVITALIZATION OF THE AMERICAN ECONOMY -- AND ESPECIALLY TO THE CREATION OF NEW JOBS. WITHOUT A SOLID ECONOMIC BASE -- ONE CAPABLE OF PRODUCING QUALITY MANUFACTURED GOODS AT A COMPETITIVE PRICE -- WE WILL HAVE LITTLE HOPE OF SUSTAINED GROWTH OR OF CONTINUED IMPROVEMENT

FURTHERMORE, WITHOUT A STRONG INDUSTRIAL BASE, AMERICA WILL SIMPLY BE INCAPABLE OF FULFILLING OUR CRITICAL RESPONSIBILITIES AS A POLITICAL AND MILITARY FORCE FOR FREEDOM IN OUR TROUBLED WORLD. TO INFLUENCE THE COURSE OF EVENTS FOR THE SAKE OF FREEDOM, WE MUST SPEAK FROM A POSITION OF STRENGTH. AND, TO SPEAK FROM A POSITION OF STRENGTH, WE MUST HAVE A STRONG ECONOMY BASED ON A FIRM INDUSTRIAL FOUNDATION.

IMPORT RELIEF MAY HAVE AN IMMEDIATE SALUTARY EFFECT. IT MAY, IN SOME INSTANCES, BE NECESSARY. BUT SUCH RELIEF IS OFTEN ONLY A QUICK FIX -- HELPFUL FOR A BRIEF TIME BUT POTENTIALLY ADDICTIVE AND, WORSE STILL, POTENTIALLY A THREAT TO THE CONTINUED HEALTH OF OUR WHOLE ECONOMY. IT MUST NOT BE ALLOWED TO DISTRACT US FROM THE NEED FOR STRUCTURAL ADJUSTMENTS WITHIN OUR ECONOMY OR TO RELIEVE THE PRESSURES WITHIN OUR ECONOMY FOR THOSE NEEDED ADJUSTMENTS.

WE MUST RESIST THE TEMPTATION TO USE TRADE REMEDIES AS AN EXPEDIENT MEANS OF AVOIDING THE FUNDAMENTAL ISSUE WE MUST FACE IN THIS RESPECT -- WHICH IS THE NECESSITY TO ADDRESS ALL THE VARIED ECONOMIC ISSUES BEFORE US WITH A COHERENT AND COMPREHENSIVE NATIONAL INDUSTRIAL POLICY.

best copy available

I REALIZE THAT THIS IS NOT A NEW IDEA. I KNOW THAT OTHERS, WITHIN GOVERNMENT AND WITHOUT, HAVE ADVOCATED THE ADOPTION OF VARIOUS SECTORAL POLICIES TO ATTEND TO THE NEEDS OF PARTICULAR INDUSTRIES WHICH HAVE BEEN AFFECTED BY OUR ECONOMIC DECLINE. WHAT WE NEED, HOWEVER, IS NOT A SECTOR-BY-SECTOR GOVERNMENT BAIL-OUT, WHICH WOULD ONLY ADD TO OUR DIFFICULTIES, BUT RATHER A NATIONAL POLICY FOR ALL OUR INDUSTRIES, AGRICULTURAL AS WELL AS INDUSTRIAL. THIS POLICY SHOULD BE NATIONAL IN SCOPE, TAKING INTO CONSIDERATION THE CHANGING STRUCTURE AND THE CHANGING NEEDS OF OUR ECONOMY. AND IT SHOULD ALSO BE INTERNATIONAL, TAKING INTO ACCOUNT OUR VITAL NEEDS TO EXPORT, TO IMPORT, AND TO COMPETE AS FREELY AND AS FAIRLY AS POSSIBLE IN OUR INCREASINGLY INTERTWINED WORLD.

WE NEED A POLICY BY DESIGN AND NOT BY INDIRECTION. THIS POLICY WILL NOT BE EASY TO IMPLEMENT. BUT IT IS NEEDED NONETHELESS.

WE MUST USE GOVERNMENT AS A CATALYST TO REVIVE THE ENTREPRENEURIAL SPIRIT IN AMERICAN LIFE AND RECONSTRUCT OUR ECONOMIC CAPACITY AS A NATION. THIS IS PARTICULARLY NECESSARY IN ORDER TO EASE THE PAINFUL ADJUSTMENT TO THE NEW ERA OF SCARCE AND EVER MORE EXPENSIVE ENERGY WHICH IS A PRINCIPAL GOAL OF PRESIDENT CARTER.

WE MUST WORK TOGETHER IN PARTNERSHIP -- GOVERNMENT, BUSINESS, AND LABOR ALIKE -- TO BUILD ON OUR STRENGTHS IN AMERICA, AND NOT SUBSIDIZE OUR INEFFICIENCIES. WE MUST NOT DISCOURAGE, THROUGH GOVERNMENTAL POLICIES, THE DEVELOPMENT OF THOSE INDUSTRIES WHICH ARE MOST LIKELY TO BE ABLE TO COMPETE. RATHER, THROUGH CAREFULLY CRAFTED TAX INCENTIVES, AND THROUGH INCREASED GOVERNMENT FUNDS FOR NEEDED RESEARCH AND DEVELOPMENT, WE MUST ENSURE THAT OUR MOST COMPETITIVE INDUSTRIES ARE ABLE, IN FACT, TO COMPETE AS THEY SHOULD -- BOTH HERE IN THE UNITED STATES AND IN FOREIGN MARKETS AS WELL.

WE MUST ELIMINATE NEEDLESS LAWS AND REGULATIONS WHICH STEM THE CREATIVE FLOW OF FREE ENTERPRISE, EVEN AS WE ENCOURAGE BUSINESS TO RENEW ITS FAITH IN FREE ENTERPRISE AS WELL. WE MUST ENCOURAGE RISK-TAKING WHERE TAKING RISKS IS IN THE NATIONAL COMMERCIAL INTEREST. WE MUST WORK TO IMPROVE OUR EFFICIENCY, OUR PRODUCTIVITY, OUR TECHNOLOGY, AND OUR QUALITY CONTROL. WE MUST ALLOW ACCELERATED DEPRECIATION ON PLANTS AND EQUIPMENT AS A NECESSARY SPUR TO MODERNIZING OUR ANTIQUATED INDUSTRIES. AND WE MUST DEVELOP ADDITIONAL POLICIES AS WELL TO ENCOURAGE SAVINGS AND INVESTMENT IN ORDER TO STIMULATE NEW JOBS, NEW WEALTH, AND NEW ENTERPRISE. ALL THIS IS ESSENTIAL TO AN EFFECTIVE NATIONAL INDUSTRIAL POLICY.

I AM ENCOURAGED BY THE FACT THAT, INCREASINGLY, OPINIONMAKERS AND DECISIONMAKERS, BOTH WITHIN GOVERNMENT AND WITHOUT, ARE RECOGNIZING THE NEED FOR SUCH A PLANNED POLICY. AND I AM CONFIDENT THAT, IN GIVING THIS MATTER THE SERIOUS ATTENTION IT DESERVES, WE CAN FORGE THE FRACTIOUS PIECES OF OUR COLLECTIVE WISDOM INTO THE EFFECTIVE, INTEGRATED, OVERALL POLICY OUR NATION NEEDS TO PREPARE FOR THE CHALLENGES OF THE COMING DECADE AND THE COMING CENTURY.

TOGETHER, WE MUST REBUILD THE INDUSTRIAL FIRMAMENT OF THE AMERICAN ECONOMY. AS WE DO, WE WILL GIVE HOPE TO ALL THOSE AMONG US WHO LONG FOR A HOME, A JOB, A FUTURE -- FOR A BETTER LIFE. WE WILL SAFEGUARD THE STATURE OF THIS NATION AS A FORTRESS AND A FOUNTAINHEAD FOR FREEDOM. WE WILL MAKE AMERICA MORE LIKE AMERICA SHOULD BE.

# # # #

Exhibit B

S.2757 provides DISC eligibility to all export trading companies are defined in the Export Trading Company Act of 1980. The current DISC qualification and reporting provisions are too complicated for small businesses and must be simplified if S.2757 is going to stimulate small businesses to export goods. It is recommended additions to S.2757 to amend the DISC provisions of the Internal Revenue Code to benefit small businesses be in two parts: 1) qualification for DISC status and 2) DISC reporting requirements.

I. DISC Qualification

To qualify as a DISC, and thereby receive the DISC benefit, a business must meet statutory requirements which compel the formation of a separate corporation with $2,500 in capital to be a DISC. This presents onerous record keeping and reporting duties for small businesses such as meetings, filing state tax returns, and basically additional business for lawyers and accountants. Also many small businesses operate in non-corporate form and incorporation should not be necessary to obtain DISC benefit.

It is recommended that some of the qualification requirements for DISC status be different for small and large businesses. For DISC purposes, a small business might be defined as a business which has, for example, gross receipts from exports sales of $10 million or less. Small businesses should be permitted to receive the DISC benefit without being required to form a corporation and to maintain separate books and records. The DISC benefit would be computed under the objective pricing rules. Such an entity would not be able to use the section 482 principles. Furthermore, a small business receiving the DISC benefit should not be required to file a separate DISC tax return (Form 1120-DISC). The DISC benefit could easily be included as a section or line in the standard corporate (Form 1120) or personal tax (Form 1040) returns, such as was done for a Western Hemisphere Trade Corporation.

Another simplification of the DISC qualification requirements for small businesses would be to eliminate the "gross assets test". This test requires that at least 95 percent of a corporation's assets be "qualified export assets" as defined in the Code in order to qualify for DISC benefit. If this test were eliminated for small businesses, they would be allowed to invest in business assets as they wished, thereby removing a serious constraint for the small business. The asset test has limited application for such business and, in fact, adds one more complexity that easily can be avoided.

A transition period would be necessary in leaving room for error the small DISC must be converted to a regular DISC if it grows in volume.

II. DISC Reporting Requirements

The DISC tax reporting requirements contained in the Internal Revenue Code and Treasury Regulations are burdensome to small and large companies in that they require the gathering of extensive information regarding the ultimate destination of goods sold and also extensive international boycott information. If such reporting requirements are burdensome to present DISC companies, then they would most certainly be a serious discouragement to a business which wished to obtain DISC benefit through the Trading Company concept.

The reporting requirements should be modified to varied extents for large and small businesses to facilitate use of DISC provisions. First, as mentioned above, the small business, however that term would be defined for DISC return. Second, the extensive information regarding the ultimate destination of exported goods required by Schedule N of Form 1120-DISC should be eliminated for large and small businesses alike. Most companies, accounting system does not generate ultimate destination of goods information. Third, the extensive international boycott information required in the DISC return necessitates the completion of International Boycott Form 5713. Small businesses should not be required to file this information to obtain the DISC benefit. As for large businesses, they should be permitted to attach to their DISC return the Form 5713 boycott information submitted with their corporate tax return, even if the fiscal year of the corporation and the DISC are different. To require a business to gather this extensive information twice, once for the fiscal year of its DISC, is unduly burdensome and should be eliminated.

Exhibit C

In a Bureau of National Affairs interview on June 10, 1980, H. David Rosenbloom, Treasury's International Tax Counsel responded to questions on tax reform and priority issues and DISC as follows:

Reform Options

Q. For Instance?

A. Well, I believe the Domestic International Sales Corporation (DISC) incentive is clearly inefficient. I mean, it's vertually indefensible. Even some of the strongest proponents of tax incentives, some of the strongest business supporters, have not favored DISC. The Wall Street Journal has historically taken the position that DISC is a bummer. That would be one place I would look.

Q. The recent Treasury report on DISC did not shed favorable light on DISC, did it? Also, the Administration opposes DISC, and recommended that DISC and deferral be dropped in it 1977 reform package, did it not?

A. Sure. The (Treasury) reports, I think, are devastating. President Carter proposed the repeal of DISC and didn't get all that far with it. But my point is simply that even some the people that you might expect to find on the side of DISC are opposing it, and that's a fairly unsual thing because people have a very difficult time criticizing other people's tax benefits.

If we're going to do something that cost a lot of money, and it might conceivably make sense with respect to Americans abroad, I think we have to change our attitude toward some of the other things that we have in the law that just aren't working very effectively.

Now DISC is one that sticks out, but there are a number of others. You could go through the foreign tax area, and I think you could find a number of provisions that could reasonably be changed.

I think that if we are not to end deferral, which was another of the President's proposals, we could certainly amend subpart F in various ways that would tighten those rules. Subpart F has become a tax planning device and it seems to me that that would deserve some attention.

The overall limitation on the foreign tax credit is really quite generous by comparison with what most other countries in the world have in place. We were through that issue in 1976, and I doubt that there's much interest in getting back into it now, but the fact is that if you point to other countries under 911 and 913 and say, "we should adopt their rules for taxation of foreign residents," there are a lot of other respects in which I don't think people would be so happy with.

I would enjoy, I think, the opportunity of being charged with preparing a package of simplifying and reform proposals in the foreign area that would pick up the necessary money to spend on Americans abroad. I think that would be a worthwhile project, but I think it would be plenty controversial.

Priority Issues

Q. If you had to pick the areas of international tax legislation it would be most desirable to reform, what would you concentrate on?

A. I think that the whole area of the foreign tax credit is obviously a high-priority issue right now. I think that the place of tax treaties in our overall international tax system is by-and-large a front-line issue, and particularly the U.S.-Canada treaty is and will be a front-line issue.

I think implementation of the U.S.-U.K. treaty is a front-line issue.

I think that of considerably less importance in the big picture--but nevertheless a front-line issue--is taxation of real estate in the United States. Those are, I think, the really big issues that we're facing now.

Moving over to the more significant things, I think that we will in time undertake some fairly significant reviews of DISC. I mean, DISC is basically an excrescence upon our tax laws. I just cannot be convinced that it's there indifinitely. It's unnatural growth. If it were doing a lot of good for a lot of people that might be one thing, but out reports seem to indicate that it's not. It's costing an awful lot to do what it is doing.

I think that the section 936 (ed. definition of qualified possessions source investment income--Puerto Rican Tax credit) regime with respect to Puerto Rico is a big-ticket item that this Administration is not going to back into because it has been recently reviewed. But I think that if you pursue the reports that we have put out with respect to the operation of the possession system of taxation, there are grounds for believing that it is not working all that well. Certainly, it could stand some further improvement.

The 861-8 rules is another area which was reviewed extensively, but I think remains an important area, and it could be that at some point there will be further, attention there. Some people urge us to get back into that. Others are just as pleased that we don't.

I think the rules under section 482 deserve rethinking in light of the expreience...under the present regulations.

And I suppose the area of deferral. Deferral is by no means dead, and I include in that the question of subpart F, because there are a lot of issues that come up under subpart F.

One other big issue that is also fairly hot from our standpoint is currency. We have undertaken a project to review the rules on currency, which I think is going to be a fairly long-term undertaking but which we are badly in need of. Under current law a situation has arisen where exchange gains and losses were a lot less important than they are today, and where there was a lot less attention paid to them than there is today. That's a fairly big-ticket and a very complicated item.

Senator CHAFEE. The subcommittee stands adjourned.

[Whereupon, at 6:45 p.m., the subcommittee adjourned, subject to call of the Chair.]

[By direction of the chairman the following communications were made a part of the hearing record:]

AMERICAN CONSTITUENCY OVERSEAS,
Irvine, Calif.

Hon. HARRY F. BYRD, Jr.,
Chairman, Committee on Finance, U.S. Senate, Subcommittee on Taxation and Debt Management, Dirksen Senate Office Building, Washington, D.C.

DEAR SIR: My name is George E. Fischer and I speak for the American Constituency Overseas and for the Association for the Advancement of International Education. Our members are oil workers, executives, businessmen, weapons systems technicians, aircraft service personnel, engineers, educators and those who follow the sun in search of bigger and better things to build—the American construction worker. I have been engaged in the international manpower field for 30 years. In that time I have visited jobsites on 5 continents and I have been privileged to share the lifestyle of these remarkable Americans. I offer this personal resume to qualify my remarks.

Others here today will reel off telling statistics that every American overseas knows by heart because he is one of those statistics. He lives out the daily frustration of laboring in an alien and often hostile environment side by side with nationals of other countries whose governments wisely exempt them from taxation while the American government pursues, alone, a policy of taxation that was judged ill-advised by Congress three decades ago. Permit me to quote from two letters I received from American superintendents in Saudi Arabia:

May 18, 1980.—"Wife and I are still in Saudi, we have moved to the housing at site and no longer have that 40 kilometer drive to make each day back and forth to Riyadh. Housing is nice, but we certainly are isolated out here in the desert. At times it gets to you and you get that feeling of 'what the hell an I doing out here?' I will admit that last week when Coopers and Lybrand showed me that I owe IRS over 55 percent of all the money that I actually draw on my paycheck and my counterpart a U.K. bloke gets to send all of his to the bank, the romance of foreign work wanes." —Ted Spornhauer

April 17, 1980.—"I hope that progress is being made to abolish taxes on foreign earned income as we Americans are becoming extinct over here. At the Uthmaniyah camp I was able to obtain the following information. In 1978 there were 228 Americans compared to 136 British residents, and in 1979, there were 191 Americans and 277 British. The change is really noticeable in the mess hall.

I have just transfered to Abqaiq, to work at GOSP No. 5 and I'm enclosing a clipping from the Camp Dope Sheet, on our residency figures:

"ACC Abqaiq (bachelor) encompasses approximately 104 acres (0.4 Sq. Km) and contains accommodations for 5,108 bachelor personnel. The average population during January 1980 was 2,858 including 404 personnel on leave. There were 33 nations represented. Nations with more than 100 personnel included Philippines (933), Pakistan (471), India (309), Thailand (257), United Kingdom (257) and United States (253)."

"All is going well here. Work, eat and sleep is all we do. What else is there to do in Saudi?"—Ken Mace

Many Americans have already determined that working away from their homeland is no longer rewarding or their employers have concluded that they are too costly to be competitively maintained overseas. I hope these hearings will result in an endorsement of at least one of the three bills under consideration because failure to act soon will result in a complete collapse of morale amongst the American community overseas and their morale is just as important as that of our fighting men.

In large measure, Americans overseas are civilian troops fighting hard and alone to defend American trade interests and to capture new trading territory that will create new jobs at home and increase tax revenues for their government. Make no mistake, there is a war going on out there and America is losing it. It is not a war just between construction contractors or machinery manufacturers; it is a struggle for trade supremacy at all levels all over the world. The construction worker living in a camp in Saudi Arabia competes against an Englishman or a Korean and so does the American businessman living in Hong Kong, London, or Rio de Janeiro.

Over the past three years, my colleagues and I have urged Congress to reconsider the inequities of the 1976 Tax Reform Act and the Foreign Earned Income Act of 1978 and have appealed to the IRS to liberalize the rather harsh temporary regulations thereof, on compassionate grounds. We argued that Americans who live in "hardship" posts deserve special consideration for the isolation, deprivations, and in some cases, hazard which such posts demand. And we did right to so argue. But the trade war is not limited to hardship posts; it rages on all fronts—in Riyadh, Lagos, Dubai, London, Algiers, Hong Kong, Rio, Caracas, Djakarta and wherever else in the world Americans must compete. Americans are vitally needed to man the marketing and sales bastions in these far flung frontiers.

Now one might argue that such capital cities are posh, sought after duty stations for those who want a little foreign adventure. The facts do not support that contention. The devaluation of the dollar, inflation and a general decline in the respect and affection with which Americans were once held, make even the most glamorous cities of the world unattractive. I have often said to employers that when Americans, beset with the frustrations of life overseas in general, look skyward and wonder what they are doing there, they had better be able to find the answer on their paychecks. But the taxes now extracted from their paychecks by their government make it no more attractive to be overseas than to be home.

In the past 30 year I have seen America's share of the market place decline steadily. Only 20 years ago we were almost without competition in the Middle-East. There are of course, many reasons for this decline and one of the most important is the taxation of American citizens based upon their citizenship—not their place of residence, as is the policy of our competitors.

How important are these people? Skilled U.S. workers demonstrate and teach the use of American equipment and machinery. American engineers incorporate American products in their designs. American educators teach American systems and technology and of course, who sells American products better than American purchasing agents? Americans specify, recommend and buy American products—not third country nationals.

Given these realities I suggest that rather than merely compensating Americans overseas for the deprivations which they suffer, we begin to reward them for the contributions they make to the U.S. economy. It makes no difference where Americans serve or in what capacity. Each in his or her own way contributes to the economic strength of our Nation.

There have been vile and cynical comments made by members of our government that Americans overseas do not always act as ambassadors of good will; that in some cases Americans do more harm than good. Such an implication is insulting to the American people as a whole because Amerians who live and work overseas are generally representative of the American public. Besides, I believe it is better for the world to know the good in us and the not so good in us than not to know us at all. I still believe that we are the best people in the world and when matched up against any other nationalities we continue to stand tall. Americans overseas are by and large good ambassadors and above all, good citizens. They merit your concern and encouragement. I urge Congress to free them to compete as tax equals for their country in the world arena.

Thank you.

GEORGE E. FISCHER,
Chairman.

AMERICAN CONSTITUENCY OVERSEAS,
Irvine, Calif.

Hon. HARRY F. BYRD, Jr.,
Chairman, Committee on Finance, U.S. Senate, Subcommittee on Taxation and Debt Management, Dirksen Senate Office Building, Washington, D.C.

GENTLEMEN: I have but two (2) arguments to offer:

1. Americans overseas desparately need immediate tax relief and I cannot underscore immediate too strongly. They are America's front-line in a trade war which threatens the economic survival or our nation. Their morale is dangerously low and without relief soon, they will surrender our markets and return home.

2. It is no longer appropriate to merely compensate Americans overseas for the deprivations and hardships which their posts often demand. We must reward them for the contributions they make to the American economy. The tax treatment of Americans overseas ought not be based upon geographical location or lifestyle, but upon foreign residence alone. The American businessman in London, Rio, or Hong Kong, makes a contribution to the American economy at least equal to that of the

oil or construction worker in a camp in the Arabian desert or Indonesian jungle. Hardship should no longer be a determining factor in qualifying an American citizen overseas for tax relief. The mental, emotional, and financial hardships suffered by Americans in so-called civilized cities is no less traumatic than the physical hardships and isolation suffered by those who live in remote locations. The tax treatment of all Americans overseas must be equal to that of the citizens of the nations of the world with whom we must compete—or we shall surely perish.

STATEMENT OF THE AIR TRANSPORT ASSOCIATION OF AMERICA

The Air Transport Association represents virtually all of the scheduled airlines of the Unites States, including 18 airlines which provide regularly scheduled air service between the United States and 72 foreign countries. Because the conduct of their business abroad requires the employment of U.S. citizens in foreign countries, these airlines have a direct interest in pending legislation to amend the Foreign Earned Income Act of 1978.

At the present time, U.S. airlines employ about 1,000 U.S. citizens abroad to supervise foreign nationals employed for the purpose of servicing aircraft, promotion and sales, and meeting the needs of U.S. airline passengers and shippers. Since the use of U.S. airline services from foreign locations to the United States has a favorable effect on our balance of payments, it is essential that the promotion and patronage of such services be properly initiated and monitored.

In addition, several U.S. airlines have management contracts to assist in the operation of foreign airlines which require the employment of U.S. citizens abroad. These contracts also favorably affect our balance of payments since they are a source of foreign earnings and they help influence the purchase of other U.S. services and manufactured products. Moreover, such contracts result in the development of standards of safety and service quality of direct interest to U.S. citizens utilizing the service of the foreign carriers involved.

The Foreign Earned Income Act of 1978 removed the standard exclusion of income earned abroad by citizens in private industry and substituted certain deductible expenses for U.S. tax purposes. This has imposed an economic burden on U.S. citizens employed abroad, and it has significantly increased the cost of American companies doing business abroad. Fewer U.S. citizens are willing to work abroad under these circumstances, and it has become more difficult and expensive for U.S. companies to compete in the international marketplace.

The Subcommittee has under consideration three proposals to amend the 1978 Act in order to provide relief to U.S. citizens working abroad without substantial revenue impact—S. 2283, S. 2418, and S. 2321. While all of these proposals would improve the present situation, we believe that S. 2321 is the more appropriate way to eliminate the administrative complexities and burdens imposed by the 1978 Act and to simplify the tax treatment of foreign earned income.

U.S. airlines must be able to assure the continued availability overseas of highly competent U.S. citizen technical, professional and management personnel. Enactment of S. 2321 will help make this possible. Favorable consideration of this legislation by the Subcommittee is respectfully urged.

Westinghouse
Electric Corporation

Robert E Kirby
Chairman

Westinghouse Building
Gateway Center
Pittsburgh Pennsylvania 15222

July 17, 1980

Hon. Harry F. Byrd, Jr.
Chairman, Subcommittee on
Taxation and Debt Management Generally
Committee on Finance
United States Senate
Washington, D. C. 20010

Dear Mr. Chairman:

On behalf of Westinghouse Electric Corporation, I urge the enactment of legislation to provide that all foreign earned inco of United States citizens employed abroad by U. S. corporations made exempt from U. S. taxation. Simply stated, we believe that existing law places U. S. manufacturers at a substantial disadva tage when competing in the world markets, and this law is out of step with the policies followed by other major exporting countri

The assignment abroad of U. S. personnel who have been full trained by their companies is essential to the sales solicitatio installation and maintenance of high technology products and services exported from the United States by Westinghouse and oth U. S. producers. However, the additional tax burden imposed by the recent amendments to Sections 911 and 913 of the Internal Revenue Code has resulted in a reduction of the number of these expatriates stationed abroad. This fact, combined with the resu ant additional costs incurred owing to the necessity of reimburs remaining expatriates, has caused Westinghouse and other U. S. manufacturers to be less competitive with non-U. S. manufacturer

We commend the interest shown by Senator Bentsen of Texas, Senator Chafee of Rhode Island, and Senator Jepsen of Iowa, in sponsoring legislation to ameliorate this problem. We believe S.2321, which was introduced by Senator Jepsen, would provide th best correction of the inadequacies of the current statutory provisions.

pages tightly bound

If S.2321 cannot be enacted, we would welcome, alternatively, reenactment of the law which existed prior to the Tax Reform Act of 1976, with the income exclusion being increased to reflect inflation. Additionally, allowances which merely permit an expatriate to maintain his standard of living while overseas should be excluded from taxable income because they do not increase disposable income. This kind of a solution is reflected in S.2418 by Senator Bentsen and S.2283 by Senator Chafee.

We believe the enactment of legislation to eliminate or reduce tax burdens on U. S. expatriates and their U. S. employers would result in a significant benefit to the United States as well as to the companies and individuals directly involved, and we respectfully urge your favorable consideration of these proposals. A more detailed discussion is attached to this letter.

Sincerely,

attachment

WESTINGHOUSE ELECTRIC CORPORATION
COMMENTS ON U.S. TAXATION OF EXPATRIATES

Westinghouse Electric Corporation has for many years been a major exporter of products manufactured in the United States. In the course of such activity the Company has sent several thousand United States citizens abroad, there being at the present time some 700 such persons located in approximately 50 countries. Having such a number of expatriates abroad, Westinghouse was very concerned with the action of Congress in enacting amendments to Section 911 of the Internal Revenue Code contained in the Tax Reform Act of 1976 and continues to be concerned with the inadequacy of amendments which were made part of the Foreign Earned Income Act of 1978.

We have summarized below what we believe is wrong with present expatriate tax provisions as they affect Westinghouse and its employees abroad. In addition, we have made some suggestions as to a better course of action.

Need for Improved U.S. International Tax Policy

U.S. tax policies applicable to foreign transactions have developed sporadically and have been subject to frequent reconsideration, e.g., recurring threats to repeal DISC, to reduce foreign tax credits, to eliminate U.S. tax deferral on earnings of foreign subsidiaries, and to increase taxation of U.S. expatriates. In the course of legislative considerations, often attitudes are expressed that export tax incentives are a "giveaway" and investments outside the U.S. are undesirable and should be penalized by tax provisions in order to protect U.S. labor and other competitors in the U.S. These factors create an atmosphere of doubt and uncertainty which adversely affect the evaluation and pursuit of long-term foreign market opportunities.

No such confusion or ambiguity exists in other strong exporting countries, such as those of the European Economic Community and Japan. Most exercise the principle of "territoriality" in taxation, taxing only earnings and transactions occurring within their borders and exempting, or taxing at a significantly reduced rate, earnings which are the result of foreign commerce.

Therefore, a clear and consistent U.S. international tax policy is needed not only to provide incentives and financial support for the export of U.S. goods, services and technology, but also to enable U.S. firms to participate more effectively in international markets and investment opportunities.

Need for Foreign Presence of U.S. Manufacturers

Much of the current Westinghouse export activity is of necessity generated by employees who both directly, and in conjunction with foreign sales representatives, distributors, licensees and manufacturing subsidiaries, promote the purchases of U.S.-produced equipment and related services by foreign customers. Westinghouse has found that stationing abroad specially trained employees who can develop good customer relations substantially enhances its ability to export.

A major portion of the Westinghouse export activity relates to projects of a substantial size and technical sophistication. For example, nuclear power plants containing hundreds of millions of dollars of U.S.-produced Westinghouse equipment have been installed in Brazil, Japan, Korea, the Philippines, Spain, Sweden, Taiwan and Yugoslavia. Major non-nuclear projects, such as radar installations, other power generation equipment and large electrical installations, are also being installed in a number of oth countries. These installations require hundreds of U.S.-trained supervisory personnel and highly skilled engineers, many of whom must be supplied from the U.S. by Westinghouse to insure that its equipment is installed and functioning properly. Additionally, complex projects and products sold by Westinghouse require warranties which are best carried out by U.S.-trained Westinghouse employees who are sent to the overseas sites to perform such warranty work as is required.

Given the need for U.S.-sourced expertise in the solicitation of sales, in the carrying out of projects, and in the followup to export sales, Westinghouse can maintain its volume of exports only if (1) highly skilled sales and engineering personnel can be persuaded to accept employment abroad, often for long periods, and (2) Westinghouse can remain cost competitive with foreign producers of electrical products.

Disadvantages of Current Expatriate Tax Policy

Westinghouse installation projects are often located in remote areas which lack many of the amenities of the civilized world. In such cases, Westinghouse must provide additional compensation and facilities to its employees who accept assignments to these locations. In addition, Westinghouse has generated significant sales in the Middle East, where the stationing of a U.S. expatriate generates significant housing and other costs of living because of the scarcity of acceptable living accommodations.

The pre-1976 Section 911, which excluded the first $20,000 or $25,000 of earned income from taxable income of certain U.S. expatriates, had been of some assistance to Westinghouse in holding down expatriate tax costs. However, given that the amendments to Sections 911 and 913 markedly increase the personal income tax liability of individual expatriate employees, Westinghouse has no choice but to make the employee whole with respect to the increased tax burden. In the course of so doing, Westinghouse incurs costs for tax reimbursement having a multiplier effect, since the reimbursement itself is subject to tax. Additionally, the complexity of these sections imposes an increased burden of tax compliance.

The result is a significant increase in costs attributable to overseas activity, which have to be taken into account in bidding on foreign projects and in pricing products and services for export.

This is to be compared with the treatment of most non-U.S. expatriates by their home governments. Typically, those expatriates are not taxed in their country at all on income earned abroad. Thus, U.S. suppliers may be encouraged to hire non-U.S. employees in an effort to remain cost competitive.

A recent survey of a number of Westinghouse divisions and marketing groups operating abroad revealed the following statistics:

(1) The number of expatriates employed abroad by Westinghouse has declined by 100 persons since January 1, 1978;

(2) In 1979 the average cost of compensating an expatriate employee was increased by approximately $3,500 to $5,000 as a result of estimated reimbursements of additional tax. In the case of some expatriates, tax reimbursements exceed $50,000.

Proposals

We believe that a sound case can be made for exempting U.S. expatriates from tax on foreign source income as provided in

S. 2321, which was introduced by Senator Jepsen. This would be consistent with the tax treatment afforded most expatriates of other countries. This proposal, however, has met with some opposition on the basis that large amounts of tax revenue would be lost. It would be more appropriate to view this as an opportunity to enhance the competitive position of U.S. producers, thereby stimulating an increase in exports of U.S. goods and services. Additional tax revenue resulting from higher domestic employment to meet increased export requirements as well as from profits derived from such exports are likely to more than offset any tax revenue reductions attributable to U.S. expatriates.

Alternatively, amendments should be enacted to substantially reduce expatriate tax costs, as follows:

(1) At a minimum Section 911 should be reenacted in the form in which it existed before the Tax Reform Act of 1976, with the exclusion increased to reflect inflation.

(2) In addition, those allowances which merely permit an expatriate to maintain his standard of living while present in a foreign country should be excluded from taxable income. Those allowances, for example, cost of living, housing, education, home leave transportation, and moving expenses, do not result in any increase in disposable income to an expatriate. Accordingly, they should not be taxed.

Recent bills introduced by Senator Chafee of Rhode Island (S. 2283) and Senator Bentsen of Texas (S. 2418) providing for income exclusions which range from $50,000 to $65,000 and retention of the allowance for excess housing costs are representative of this type of legislation.

Whatever changes are considered, simplification of the tax calculation and compliance requirements should be a primary objective. Present tax rules are unduly complex, requiring considerabl time and expense on the part of the employer and the expatriate in accumulating supporting data and in securing necessary tax assistance.

WESTERN [illegible]

July 9, 1980

Honorable Russell B. Long
Committee on Finance
United States Senate
Washington, D.C.

Dear Mr. Chairman:

On behalf of the National Ocean Industries Association, and in particular on behalf of its hundreds of member companies that are engaged in purveying of services overseas, I am submitting the following brief comments with respect to proposed amendments to the Internal Revenue Code of 1954; S.2282, S.2321, and S.2418.

Our Association and its members strongly support the common aim of these three bills to improve the competitive positions of United States organizations in foreign markets by reducing the relative tax burdens on U. S. employees as compared to the tax burdens borne by foreign employees working away from their homelands.

We have several comments on specific features of the bills:

A dollar limitation on exclusion of income from U. S. tax sows the seeds of future difficulties. While $50,000 or $60,000 limits would today be of considerable assistance in eliminating the burden on 80-90% of overseas employees, within five years at present inflation rates virtually all U. S. nationals employed overseas would again be heavily taxed. Another important consideration is that with the proposed limits management and high-level technical employees would even now receive only partial benefit. We note in particular that a tax differential at higher salary levels will act as an incentive to hire non-U.S. nationals as overseas managers. We would, as a result, create a foundation for foreign companies to compete with us with knowhow acquired from us. It is most important to insure the use of U. S. nationals in management and in high-level technical positions. We therefore recommend that no upper limit be placed on excluded earned income.

The various restrictive provisions defining residence requirements to obtain the proposed exclusion will result in a number of inequities. Many of our member companies operate overseas on an itinerant basis, frequently in international waters (e.g. on the Outer Continental Shelves) or in disputed jurisdictions or in undefined jurisdictions such as Antarctica. We recommend the use of the sole qualification of physical presence outside the United States for a period such as 11 out of 12 months. Return to the United States as frequently as once a year is required for retraining in highly technical fields.

We would recommend that housing-allowance deductions under section 913 be eliminated provided there are no limits on the amount of earned income that may be excluded. Establishing the value of actual housing allowances in many overseas situations is virtually impossible and places an accounting burden on individual employees who are in no position to do anything but assign arbitrary values to facilities and services denominated in foreign, non-convertible currencies.

We suggest that in defining income to be excluded such phrases as "amounts received from sources in a foreign country" or "amounts received from sources without the U. S." would cause considerable difficulty. Many of the employees of our member companies are paid from within the United States by those companies. Retaining such income definitions would have the unfortunate result of affording tax relief to U. S. citizens employed by foreign companies, but not to U. S. citizens employed by U. S. companies. We would suggest therefore that the definition be couched in terms such as "earned income earned outside the U. S." or "amounts received in compensation for services rendered outside the U.S."

I would also request the liberty of including the attached remarks which were prepared for oral presentation before your Committee in anticipation of an invitation to appear personally. This material is intended as background in support of the above recommendations.

Sincerely,

Carl H. Savit

CHS:bs
Attachment

TESTIMONY PREPARED FOR PRESENTATION TO COMMITTEE ON FINANCE HEARING

JUNE 27, 1980

Mr. Chairman:

I am Carl H. Savit, Senior Vice President, Western Geophysical Company of America. I am appearing on behalf of the National Ocean Industries Association. I, myself, represent the geophysical exploration industry, an industry which is primarily engaged in pre-drilling exploration for oil and gas and to a lesser extent, for other non-renewable resources. We use sophisticated methods and advanced technologies to deduce a considerable amount of information about the geological structures deep beneath the earth or the sea. Oil companies use the information that we generate to help them select the places they wish to drill.

About half of the industry's three-billion-dollar current annual volume consists of services performed outside the United States. Our industry is a service industry and we are exporters of services. My company, Western Geophysical, is the largest in this industry and we have about one-seventh of the total market. Several other companies are quite near to us in size and competition is active so that the experiences in the market of any of the major companies are found to be representative of all.

Consequently, I shall address the subject of the income-tax treatment of U. S. nationals working abroad from the viewpoint of Western Geophysical Company with whose experiences and activities I am most familiar.

Thirty years ago, when I first travelled out of the United States to visit our field operations, most our field parties consisted of U. S. nationals in the key technical and semi-technical positions. Semi-skilled and unskilled labor was performed by nationals of the countries in which we were operating. When the field party moved on to another country, only the American staff moved. Today the technical and semi-technical cadre frequently consists of an international group. In some cases none are American.

From a situation in which nearly all of our "permanent" cadre overseas was American we have today reached a situation in which only about 22% are citizens or permanent residents of the U.S.

The erosion of a U. S. presence in our overseas operations began to be felt near the beginning of the past decade when the compensation of a substantial number of our senior personnel began to exceed the compensation limits for exclusion of income from U. S. income tax. To retain these key people we had to increase their total compensation substantially. In order to reduce our costs so that we could remain competitive against our European competitors, however, we gradually began to replace Americans in key cadre positions. The tax law changes of 1978 accelerated the trend toward hiring and training non-U.S. personnel since it then became much more difficult to offer after-tax salaries large enough to retain high-quality technical help from the U. S. in jobs that inherently required many personal sacrifices.

We observe that foreign nationals trained by U. S. companies often leave our employ when they have acquired a high proficiency. They join competitive foreign firms or even form new companies that sooner or later begin to bid against us. One such new company is now actively competing in the U.S.!

One hopeful note is that there has been a surge in the past four years in worldwide geophysical exploration activity so that the total number of our U. S. nationals abroad has begun to increase. The ratio of U. S. to foreign nationals has nevertheless decreased.

We welcome the proposed legislation that forms the basis of this hearing as a constructive step to halt and perhaps to reverse the recent employment ratio trend. Our U. S. companies might then have a reasonable chance to compete against organizations from other nations that do not tax the foreign-source income of their citizens.

If the present tax structure is not corrected, a larger and larger share of the compensation paid by U. S. geophysical contractors will be received by citizens of other countries.

In discussions of taxation of foreign-source income prior to passage of the 1978 act, a prime motivation in retaining taxation of foreign source income was the presumed loss of revenue to the Treasury that would ensue. The results of that taxation however indicate that competitive forces transferred the payrolls to foreign nationals and thus placed geophysical salaries outside the taxing power of the United States.

GHS:ba

KIMBERLY-CLARK CORPORATION

PAUL A. JONES
SENIOR STAFF VICE PRESIDENT

July 10, 1980

Mr. Michael Stern
Staff Director
Senate Finance Committee
Room 2227
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Stern:

As you know, on June 26 the Senate Subcommittee on Taxation and Debt Management held a hearing on three bills (S. 2283, S. 2321, and S. 2418) introduced for the purpose of improving tax benefits for expatriates of the United States working abroad. Kimberly-Clark Corporation had requested and was prepared to testify at the hearing, but our request could not be accommodated due to the large number of other witnesses scheduled to appear. This letter incorporates the reasons for our support of these bills, and we respectfully request that these comments become part of the official hearing record.

Kimberly-Clark Corporation is a worldwide manufacturer of fiber-based products for personal care and other diverse markets with operations in 20 U.S. states and 20 foreign countries and territories. Our total worldwide employment is over 30,000 and our annual sales are approximately $2.2 billion.

We are in general support of the provisions contained in all three bills now pending before the committee. These bills, in varying degrees, would allow for annual tax exclusions for income earned abroad and represent a significant improvement over existing law.

When U.S. employees are sent abroad, the general experience of U.S. firms is that the impact of the expatriates' tax liability falls

KIMBERLY-CLARK CORPORATION NEENAH WISCONSIN 54956 PHONE (414) 729-1212
An Equal Opportunity Employer

on companies like Kimberly-Clark, which utilize a "tax equalization" plan to compensate expatriates. In effect, any foreign and U.S. taxes that are imposed on an agreed "base salary" are reimbursed to the employee, so that the employee is assured of receiving a net amount that is roughly equivalent to the after-tax earnings that he would have received on the same job in the U.S. In practice, this means that the actual cost to Kimberly-Clark of maintaining an American in a foreign-based job can be more than double the actual U.S.-based salary. This added cost contributes to a competitive disadvantage with other companies not employing U.S. citizens. Such discriminatory treatment by the U.S. government of U.S. companies and U.S. citizens is patently unfair and cannot conceivably be in the best interest of the United States. Recent legislative changes dealing with the U.S. tax treatment of expatriates have done little to remove the inequities that create this burden on U.S.-based corporations.

Although factors other than taxes are considered when filling a position in a foreign country, because other countries do not tax the overseas income of their nonresident citizens, the non-U.S. expatriate is given a natural preference. When this advantage is contrasted to the treatment of American expatriates, the practical effect is to make Americans the last choice for overseas assignments. Again, this unnatural interference with American business is both unfair and incomprehensible.

Kimberly-Clark's experience bears this out. Over an eight-year period (1968 through 1975) the number of U.S. citizens employed by Kimberly-Clark affiliates overseas averaged 33 per year, reaching a high of 36 in 1974. Today, the number has been reduced to 15 -- a 55 percent reduction. A principal reason for this decline has been the increased cost to Kimberly-Clark of maintaining compensation equity through the process described earlier.

Finally, the admittedly small loss of revenue estimated by the Treasury makes the provisions of the current law even more of a mystery. We suspect that the genesis of the current treatment of expatriates can be traced to the need for a rallying point for tax reformers. American expatriates, styled as living in luxury in exotic foreign capitals became a convenient target just as did some years earlier the 200 millionaires who paid no U.S. taxes. It is time to recognize that most U.S. expatriates give up a lot to journey to what are mostly below U.S. living standard assignments abroad. More important, perhaps, is the need to relieve U.S. businesses of at least the added burdens of competing overseas which have been placed on them by their own government.

Very truly yours,

Paul A. Jones
Paul A. Jones
Senior Staff Vice President

PAJ:R

July 11, 1980

STATEMENT OF MR. J. P. JANETATOS OF BAKER & MCKENZIE ON BEHALF OF THE ASSOCIATION FOR THE ADVANCEMENT OF INTERNATIONAL EDUCATION

SUBMITTED TO THE SENATE FINANCE COMMITTEE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT WITH RESPECT TO PROPOSED LEGISLATION AFFECTING THE TAXATION OF U.S. CITIZENS ABROAD

This statement is submitted on behalf of the Association for the Advancement of International Education (AAIE) for the purpose of presenting AAIE's views with respect to S. 2283, S. 2418 and S. 2321.

AAIE is a U.S. nonprofit association of individuals and organizations sharing a common interest in the promotion and improvement of international education. AAIE's membership includes approximately 500 school systems located throughout the world and its activities are primarily directed toward benefiting U.S. school teachers and administrators who live and work abroad.

Also associating itself with this statement is International Schools Services, Inc. (ISS). ISS is a U.S. nonprofit organization which was formed in 1955 to support and advance the education of American elementary and secondary school children living outside the United States. Its activities in this regard include recruiting teachers and administrators from the United States and establishing and operating schools for dependent children of industrial clients.

Certain additional information set forth below, by the way of example, has been obtained from The American School of the Hague located in the Netherlands. That institution provides classroom instruction to approximately 825 elementary and secondary school children, approximately 57 percent of whom are children of U.S. employees of U.S. business corporations. In addition, over 90 percent of the School's 82 professional staff members are U.S. citizens.

H.R. 1319

At the outset, AAIE recognizes and appreciates the special consideration given to employees of charitable and educational organizations by H.R. 1319, which was reported favorably by the Senate Finance Committee and presently awaits Senate floor action. However, we do not feel that H.R. 1319, if passed, will be particularly helpful to a significant number of the U.S. teachers and administrators living and working abroad because the $20,000 income exclusion option provided for in that bill applies only to individuals working in "lesser developed countries." Since approximately 20 percent of the U.S. teachers and administrators working abroad are located in industrially developed countries, H.R. 1319, as presently drafted, would not benefit those U.S. educators. We understand that this "lesser developed country" restriction was a last-minute amendment designed primarily to satisfy certain budgetary constraints and to permit consideration of other legislative items. We believe that this "lesser developed country" limitation makes little sense from either a practical or equitable standpoint and we strongly urge that serious consideration be given to eliminating this restrictive provision at any House-Senate conference which might be held with respect to that bill. If the Finance Committee believes that there is any rational basis for this restriction, we would welcome the opportunity to present a fuller explanation of the situation confronting school teachers in the affected countries.

Relationship Between U.S. Schools Abroad and U.S. Export Trade

Focusing upon the three Senate bills that are the subject of these hearings, we would first like to address and correct the misconception that the educational activities and services provided by U.S. educators abroad are unrelated to U.S. export trade. For example, we note that in a recent interview conducted by the Bureau of National Affairs with Mr. H. David Rosenbloom, the Treasury Department's International Tax Counsel, Mr. Rosenbloom made the following statement in commenting upon the relationship between the U.S. system of taxing its citizens abroad and the U.S. export position:

> There are some Americans abroad in situations, teachers for example, which may be deserving for other reasons, possibly, but certainly are not export-related jobs. [BNA Daily Report for Executives, June 13, 1980, p. K-2]

Nothing could be further from the truth. In actuality, one of the most important concerns of Americans working overseas in export-related positions is the quality of the education their children will receive while they are abroad, and most Americans will not accept overseas assignments without some provision made for their children's education. For this reason, there presently exists throughout the world a network of U.S. type schools staffed with U.S. teachers and administrators who provide elementary and secondary education for children of employees of U.S. companies that are deeply involved in export-related trade.

In this regard, we should point out that one of the functions of ISS is to gather and disseminate current data concerning all overseas schools with American students enrolled. Thus, ISS is particularly well qualified to comment upon the relationship between these U.S. type schools and the dependents of employees of U.S. corporations operating abroad. In this regard, ISS has informed us that there are presently approximately 225,000 children of U.S. citizens attending U.S. type schools abroad and that approximately 70 percent of these students are children of employees of private sector companies.

Although there are many teachers directly employed by U.S. companies abroad, most teachers and administrators working abroad are not employed directly by the companies whose employees' children benefit from the classroom instruction. In a very real sense, however, these U.S. educators work for all business companies operating abroad since these schools are essential to attract overseas employees. Moreover, there are seldom any alternative means by which the employees' children can obtain an education comparable to that which they would receive in this country.

An additional and often overlooked connection between the operation of U.S. schools abroad and U.S. export trade is the vast quantity of educational materials and supplies as well as classroom furnishings and equipment which are purchased by these schools from U.S. companies. For example, over the past four years, the 25 U.S. overseas schools sponsored by ISS have purchased approximately $6,000,000 worth of supplies and equipment from U.S. companies. Moreover, this figure represents only the 25 schools connected with ISS and does not include the many additional overseas schools which purchase supplies and equipment in even greater quantities. Thus, in addition to providing an important support function for U.S. companies involved in export trade, the establishment and operation of these schools contribute directly to the U.S. export trade position.

Adverse Effects of Present Taxation System on U.S. Schools Abroad

The U.S. schools operating abroad, perhaps more so than most organizations, operate under extremely restrictive budgetary constraints. One way for these schools to absorb the rising personnel costs associated with higher U.S. taxes is to increase the tuition charged to the students. This, in turn, increases the cost the companies must bear to ensure that their employees' dependents receive a proper education while they are abroad. If the companies cannot or will not bear these additional tuition charges, the schools' rising personnel expenses can only be offset by cost-cutting measures that will, at best, diminish the quality of the education the schools can provide or, at worst, eliminate these schools altogether. Either event would make it increasingly difficult for companies to attract employees for overseas assignments.

Moreover, as pointed out by testimony presented at hearings held on June 26, 1980, the present manner in which the U.S. taxes its citizens abroad is causing, and will continue to cause, a significant increase in the number of American workers leaving overseas assignments and returning to the U.S. Among those returning personnel will be teachers and administrators who will have more difficulty than most in finding domestic employment. An additional danger is that a decrease in the number of Americans working abroad for U.S. companies will cause a corresponding reduction in student enrollment at these U.S. type schools. For example, the American School of the Hague informs us that its student enrollment has dropped by approximately 22.5 percent since May 1978. A continuation of this type of trend will cause employment cut-backs and layoffs at these schools that will severely damage the quality of the education provided by overseas schools and threaten their continued existence. The American School of the Hague has already experienced a 10.8 percent decrease in staff employment over the past year and expects an additional 12 percent decrease in the coming year.

Conclusion

In summary, AAIE shares the views expressed by others that the passage of legislation similar to S. 2283, S. 2418, or S. 2321 is necessary to reverse the current adverse trend in the

U.S. export position. In this regard, however, we strongly urge the Congress not to be mislead by the claim that U.S. teachers and administrators working abroad bear no relationship to U.S. export trade. On the contrary, these U.S. educators, who provide quality education to U.S. dependents living abroad, perform an invaluable service for U.S. companies operating abroad without which the U.S. export trade position would greatly suffer.

TRW

EXECUTIVE OFFICES

July 18, 1980

The Honorable Harry F. Byrd, Jr.
Chairman
Subcommittee on Taxation and Debt Management
U.S. Senate Committee on Finance
2227 Dirksen Senate Office Building
Washington, D. C. 20510

Attention: Mr. Michael Stern
Staff Director

Dear Senator Byrd and Members of the Subcommittee:

I am writing on behalf of TRW Inc. to support reform of the Internal Revenue Code Section 911 foreign earned income exclusion and the Code Section 913 excess foreign living cost deductions in line with the proposals contained in S. 2283, S. 2321, and S. 2418. We would appreciate having our comment made part of the official record of hearings on this legislation if that is still possible.

TRW Inc. is a diversified manufacturing firm with substantial participation in worldwide markets for car and truck components, electronics and space systems, and industrial and energy products. Total sales for 1979 were $4.5 billion, and we have approximately 98,000 employees. Our operations are located in all parts of the United States and in 25 foreign countries. Thirty-four percent of TRW's business last year was derived from international markets, including 30 percent in sales from our subsidiary companies abroad.

Our strong position in international markets has helped us gain and hold market share in our industrial lines worldwide, and this, in turn, has enabled us to keep overall earnings, investment and employment at high levels despite business fluctuations in individual countries. This strength has directly benefitted our operations in the United States. In the area of capital formation, for example, TRW has repatriated over $275 million from foreign earnings during the last decade.

We think our experience exemplifies the need of many United States companies to operate throughout the world if they are to meet the competition, and it illustrates the advantages accruing to the United States from having companies which can compete on a worldwide basis.

To remain competitive, however, United States companies must be treated fairly by both the United States and foreign governments. Fair treatment means, above all, that United States companies must be given substantially equal treatment by the U.S. Government compared with treatment accorded to

TRW INC. · 2030 M STREET, N. W. · SUITE 800 · WASHINGTON, D. C. 20036

foreign companies by their governments. We believe it was in recognition of this essential point that the Senate has had the wisdom to turn back attempts made in recent years that would have placed United States companies at a competitive disadvantage compared with foreign companies. Examples which come to mind include proposals that would have cut back the foreign tax credit, imposed U.S. tax on foreign earnings before they were repatriated, and ended DISC.

It is now time to address another area in which the United States Government should take action to see that its companies are treated fairly - to put them in a position where they can compete on an equal basis with foreign companies. This is the area of taxes levied on the income earned by U.S. citizens working abroad.

Foreign Competition and the Citizenship Basis of Taxation

The experience of our company, I feel certain, exemplifies the basic point that in order for a U.S. firm to be successful in its foreign operations it must, on occasion, station its U.S. citizen employees abroad for extended periods of time. We have done this in order to expand export sales, to service and operate equipment, to advise foreign purchasers, to manage production operations and projects, and to keep in better touch with legal and political developments.

At present we have 125 U.S. citizens abroad engaged in these tasks. Without them, it would be virtually impossible for us to make certain sales or fulfill certain contracts. This, in turn, would reduce our market share and make us a weaker competitor in the international marketplace. This experience, extended to other U.S. companies, would mean national balance of payments problems even more serious than they are now and a U.S. economy that is even weaker in international competition. In brief, it is essential to the national interest that U.S. companies be able to assign U.S. personnel abroad where needed to pursue business interests. The fact is, however, that present U.S. tax law applicable to citizens working abroad imposes a burden that citizens of foreign countries and their companies do not bear. The U.S. Government has put U.S. citizens and businesses in a disadvantageous competitive position — contrary to the national interest.

So far as we are informed, no other important trading country besides the United States and Switzerland taxes the foreign earned income of their citizens. Furthermore, unlike the U.S., there is generally no taxation of special items of income, such as incentive bonuses and income earned outside of the foreign country of employment.

This consideration - fair treatment of U.S. citizens and companies so they can compete on an equal basis with foreign companies - has simply not been given sufficient weight in designing U.S. tax law. Just as in certain other areas relating to the international sector, some officials of government still insist on basing their views of what is appropriate on domestic U.S. tax ideas rather than on international practice. They have not yet perceived the enormous exposure which U.S. businesses and their employees have to the powerful forces of international competition and the need for the U.S. government to give its businesses a fair chance to meet that competition.

Treasury's defense of the present law is based only on the view that U.S. citizens working abroad should also contribute to supporting the government of the U.S. with their personal income taxes, although it recognizes that citizens working abroad deserve some special exemptions and deductions because of higher costs and hardships related to being abroad. Treasury does not ask what the competition is doing; it decides what is equitable based only on domestic U.S. considerations. This is the basic flaw in the Treasury position. The three bills being considered by the Committee, by contrast, do take account of other countries' practices while retaining the fundamental policy of citizenship basis taxation. A change in the law in the direction they point would serve the national interest.

Relative Cost of Keeping U.S. Workers Abroad and the Consequences

A body of data is being accumulated and has been presented to the Subcommittee indicating that the 1978 changes in the tax law relating to U.S. workers overseas has generally raised the cost of having these individuals serve in foreign posts. Even Treasury' testimony to the Subcommittee recognizes that U.S. personal income taxes add to the costs of U.S. firms operating abroad.

Foreign citizens who generally need pay no tax to their home governments can be hired and trained at less cost to a U.S. company, and substitutions of foreign for U.S. citizens are taking place. This not only shrinks employment opportunities for U.S. citizens, but it also tends to reduce U.S. exports of goods and services. As many witnesses have pointed out, foreign employees tend, where the option is available, to order from firms in their home countries rather than from U.S. firms, because they are familiar with the product and consider it more in their long-term personal self-interest to order from their country's firms.

While the total magnitude of these cost differences, shifts, and substitutions can be debated, quarrels over magnitudes should not divert attention from the basic, common sense, plausible thesis that the increased costs of stationing U.S. citizens abroad are reducing their numbers compared with foreign citizens, and that this reduction has definite adverse consequences for U.S. foreign sales, employment of U.S. citizens, and for the earnings of U.S. companies and U.S. citizens.

The U.S. needs a basic policy which supports the assignment of company employees abroad and does not get bogged down in excessive legalistic or model-building detail. The bills being considered by the Committee would, in comparison with present law, tend to advance the basic policy of supporting U.S. international economic interests.

Tax Harmonization and Simplification

Apart from the compelling need to bring the substance of U.S. government policies in all areas, including this one, to the point where U.S. firms are no longer disadvantaged by their government in international competition, the constant trend toward closer commercial linkages among countries urgently suggests the need for greater harmonization of commercial practices, including taxes.

The cost burden on business of having to deal with an already labryinthian complexity of differing national tax laws is very heavy. U.S. practice in the area of taxing citizens employed abroad is greatly out of step with foreign practice, which focusses on exclusion of income from tax rather than a set of complicated deductions. U.S. firms would benefit greatly from the standpoint of administrative simplification by having U.S. practice brought more into line with that of the rest of the world. Tax harmonization and especially tax simplification have been objectives of most Administrations and many in Congress. These bills would tend to advance these objectives in a significant way.

__Residency Requirement Waiver in Abnormal Situations__

S. 2418 introduced by Senator Bentsen contains a provision which would authorize the Secretary of the Treasury to waive the minimum foreign residence requirements with respect to U.S. citizens working abroad who could reasonably have been expected to meet those eligibility requirements, but who left the foreign country under conditions of war, civil unrest, or similar conditions which precluded the normal conduct of business. This provision would apply to those who left a foreign country after September 1, 1978, and thus would cover U.S. citizens who were forced to leave Iran after that date because of the revolution.

We support this provision and wish to note that legislation designed to accomplish this type of waiver, including for U.S. citizens forced to leave Iran after September 1, 1878, has benn approved by the House of Representatives and the Senate Finance Committee. The Treasury Department has stated that such relief is desirable in the circumstances and that the bill is suitably tailored to provide such relief. We recommend that this provision, including its applicablilty to Iranian evacuees, be included in this legislation.

Sincerely,

Peter F. Warker
Director
International Affairs

egc

Deloitte
Haskins+Sells

Executive Office

1114 Avenue of the Americas
New York, New York 10036
(212) 790-0600
Telex 12267

July 10, 1980

Senator Harry F. Byrd, Jr., Chairman
Subcommittee on Taxation and Debt
Management
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Sir:

The purpose of this letter is to submit our comments on the proposed revision of the rules governing taxation of United States citizens and residents who are working in foreign locations. Specifically, our comments address the following three Senate bills:

. S. 2283, introduced by Senator Chafee,

. S. 2321, introduced by Senator Jepsen, and

. S. 2418, introduced by Senator Bentsen.

In addition, we have included a brief review of the history of the United States expatriate taxation rules, discussion regarding difficulties and inequities of present statute provisions for such taxation, and our recommendations for meaningful legislative changes. These changes should help to remedy the existing inequities for expatriate employees

and their employers, and mitigate or eliminate the adverse effects on the United States presence and competitive position abroad caused by the current tax law for U.S. expatriates.

LEGISLATIVE HISTORY OF EXPATRIATE TAXATION

Congress has been dealing with the complicated issues of taxation of U.S. expatriates for more than fifty years, beginning in the 1920s as the United States grew in its role as a major exporting country after the disruptions of world trade caused by World War I. From the beginning, Congress recognized the competitive disadvantages that U.S. firms encountered in the world marketplace as compared with foreign firms, whose nationals were often exempt from domestic taxation when employed outside their home countries. In answer to this problem and in support of the public policy of encouraging foreign trade, legislation was enacted in 1926 that virtually exempted from U.S. taxation the income earned by Americans working abroad.

. 1926 to 1976

When the "foreign earned income exclusion" was first introduced, it was very broad and enabled U.S. companies to compete on more nearly equal terms for foreign business. It appeared to be accomplishing the stated purpose of increasing the trade of U.S. firms that especially suffered in overseas competition

through individual taxation policies. It was not long, however, before the exclusion came under criticism, and pressure was exerted to modify the provision.

In 1932, Congress avoided efforts to modify the exclusion substantially and, instead, acted to close an area of abuse by amending the law so that income paid by the United States or any agency thereof was not eligible for the exclusion. For about ten years, there were no further serious attempts to change the foreign earned income exclusion. In 1942, however, there was a strong move by the House Ways and Means Committee to repeal the provision because of certain additional abuses.

Again, the action taken by Congress, led by the Senate Finance Committee, resulted in an effort to remedy abuses rather than repeal the entire section. Under the changes brought about by the Revenue Act of 1942, the exemption of foreign earned income was applicable only when the U.S. citizen became a bona fide resident of a foreign country for an entire taxable year, instead of the previous more liberal qualification requirement. Although this change did result in some unintended hardships, these were certainly less onerous than complete repeal of the exemption.

During the early 1950s, additional revisions were made in the taxation of overseas Americans. These changes were brought about principally because of concern about abuses by certain individuals, such as actors and actresses, who received large amounts of compensation and could avoid U.S. income tax simply by working abroad. The most important change by Congress was to impose a maximum limit of $20,000 on the exclusion. It is important to note that Congress felt that all of the income and allowances of most individuals would continue to be excluded by falling under the $20,000 ceiling.

Between 1953 and the mid-1970s, the exclusion and the foreign residency tests were subjected to additional technical adjustments. Substantially, however, the operation of the provisions remained intact. The value of the exclusion, unfortunately, was significantly reduced. While the basic $20,000 exclusion remained constant, the effects of inflation caused salaries, benefits, and living costs abroad to rise above that amount for most people. The original intent of Congress to exclude the entire earned income from performing services abroad was, for most individuals, no longer being served by existing legislation.

. Tax Reform Act of 1976

Considerable debate accompanied the 1976 legislative changes in section 911, IRC. Although many Members of Congress were concerned that the competitive position of U.S. firms operating abroad should not be harmed, overzealous attention was directed at ensuring that Americans overseas were not gaining preferential tax treatment. It was feared that, by combining the $20,000 or $25,000 exclusion of income earned abroad with the allowance of full foreign tax credits attributable to all income, taxpayers who paid taxes to foreign governments received an unintended benefit.

Acting on these concerns, section 911, IRC, was amended both to reduce the maximum exclusion to $15,000 for most taxpayers and to provide for the disallowance of foreign taxes applicable to the excluded income as a deduction or for U.S. foreign tax credit purposes. Compounding the problem, it was decided that the non-excluded income was to be taxed by the United States at the higher marginal rates applicable if no income had been excluded.

After the effects of the 1976 Act changes were analyzed, it soon became clear that the end result was a disaster. The benefit of the exclusion, even before considering the loss of foreign tax credits, was reduced to a maximum of only about $3,000 per person. For some taxpayers abroad, it was more beneficial to simply elect not to use the section 911, IRC, exclusion at all, rather than suffer the loss of foreign tax credits that could exceed the exclusion benefit.

. Foreign Earned Income Act of 1978

Congress quickly realized that the 1976 legislative changes would lead to unacceptable hardships for U.S. taxpayers abroad and could severely restrict export marketing opportunities beneficial to the American economy. After twice postponing the effective date of the section 911, IRC, changes, a comprehensive revision of the U.S. tax treatment of Americans working abroad was passed to replace the law in the form that had generally existed since the 1926 legislation. The Foreign Earned Income Act of 1978, however, was not adequate to deal with the substantial problems of inequitable taxation of U.S. expatriates and maintenance of a favorable U.S. competitive position abroad.

CURRENT TAXATION OF EXPATRIATES

A U.S. citizen or resident accepting employment abroad is usually faced with a higher cost of living than in the United States. To compensate for that higher cost of living the employer must generally offer higher income and allowances. The extra amount is primarily meant to cover the additional costs incurred as a result of living abroad. In this sense, the extra amount is not compensatory at all, but merely permits the U.S. citizen to maintain roughly the same standard of living he would enjoy in the United States on the lower income. Under U.S. tax law, however, all income generally is taxable unless specifically exempted. Consequently, reimbursement of the excess costs of living abroad is seen as taxable income even though it represents no real economic gain to the employee. As the employee's taxable income increases, so does the U.S. tax liability. Section 913, IRC, was written to mitigate the increase in tax liability of U.S. citizens working abroad that is caused by this artificial increase in taxable income. It is structured to allow deductions for the excess costs of working abroad and thereby reduce the expatriate U.S. citizen's taxable income to what it would be had he or she not been working overseas. In short, the purpose of section 913, IRC, is to eliminate the difference in tax liability between U.S. citizens working at home and those working abroad whose real economic income is equal.

In concept, the law seems to represent a logical approach to achieving the goal of providing tax equity for U.S. expatriates. The relief provided to U.S. overseas employees should increase to cover the rising costs associated with their assignments. If all such costs were properly identified, the deduction of these items from taxable income would remove much of the inequitable taxation of these individuals.

Even though all of the higher costs of maintaining Americans in overseas locations were not identified and dealt with in the 1978 legislation (such as the pyramiding effects of tax equalization payments), substantial progress toward a tax equity goal could have been accomplished if overly restrictive proposed and temporary regulations under the deduction provisions had not been issued by the Treasury. The effect of the temporary regulations, which were written from the perspective of prevention of certain perceived abuses that might occur, was to render administration of the law needlessly complex and effectively to frustrate Congressional intent.

The Foreign Earned Income Act of 1978 also made significant changes in the provisions that allow certain individuals to exclude some of their foreign earned income from U.S. taxation. Under these rules, qualifying individuals residing in camps located in hardship areas abroad may claim an exclusion of up to $20,000 annually of foreign earned income instead of using the section 913, IRC, provision for deduction of certain expenses of living abroad. The section 911 "camp exclusion," even under the most recent temporary regulations, remains extremely complex as to when it does and does not apply. Of course, even ignoring the uncertainty of application, an exclusion of $20,000 established in the 1950s is hardly adequate now.

If the section 913, IRC, deduction provisions are to accomplish the intended purpose of providing tax equity for U.S. taxpayers abroad to any useful degree, the needless complexity and restrictiveness of the temporary regulations under that section must be reduced. Some examples of these problem areas follow.

. Source of Deduction

In computing the foreign tax credit limitation under section 904, IRC, the regulations require that the deduction allowed by section 913, IRC, be wholly allocable to income from sources without the United States. Therefore, even though some of the income used for the payment of foreign expenses may have either a U.S. or a foreign source under long-standing IRS interpretations, the regulations require that the deduction arising from the expenses and from the foreign assignment can have a foreign source only. The effect of this inconsistency is potentially to disallow foreign tax credits merely as a result of claiming the benefits of section 913, IRC. This clearly goes beyond statutory provision.

. Housing Expense Deduction

Two factors significantly restrict the housing expense deduction from accomplishing its intended purpose of placing the expatriate family housing costs on a level approximating what a family might pay for housing in the United States. First, the regulations determine that certain costs will automatically be disqualified from housing expenses, even without the tests of reasonableness or lavishness being applied. The result is to prevent taxpayers abroad from claiming a deduction for certain expenditures that were comprehended in the statute. Second, the base housing amount, which reduces the amount of housing expenses that can be claimed as a deduction and is supposed to approximate what a family in the United States would pay for comparable housing, is often overstated because the base salary is artificially inflated by tax equalization payments.

The result of the operation of the two factors is the understatement of a fair housing expense deduction for many expatriate taxpayers who must rent their homes abroad. In some foreign locations, such as Saudi Arabia, where even modest housing can cost $60,000 or more a year in basic rent, the burden of an unrealistic housing expense deduction is severe and must be alleviated.

. Home Leave Expenses

The regulations require that, for full deduction of transportation costs, the taxpayer must visit the present or most recent principal residence location in the United States, even if that residence is no longer relevant to the taxpayer and his family. Furthermore, the regulations generally exclude from the category of reasonable home leave travel expenses expenditures for first class travel, meals, and lodging en route. This element of the section 913, IRC, deduction is, thus, severely restricted and rendered less effective.

. Spouses Employed Abroad

In a greater number of U.S. families than ever before, both spouses are working, and often both will expect to continue their careers even if an overseas transfer of one is contemplated. Under prior law, each spouse was allowed a separate earned income exclusion, and in many cases the wife's income fell within the exclusion's maximum limitation. In the past, therefore, there was an added incentive for working families to accept overseas assignments.

However, under the current provisions of section 913, IRC, the wife's income is subject to the very high incremental rates on the joint return and is often taxed at the 50 percent maximum rate for earned income. In addition, the earnings by the spouse actually reduce the housing deduction to which the family is entitled by the application of the base housing amount provision. By taxing the income at 50 percent and reducing the housing deduction by approximately $20 for each $100 that the spouse earns, there is little, if any, incentive for a working couple to go overseas.

NEED FOR LEGISLATIVE REFORM

In the past few years there have been a number of government and private research studies on the effects of expatriate taxation policies on U.S. export trade capabilities and our operating competitive position abroad. With virtual unanimity, these studies (as recent as last month) have found persuasive evidence that our comparatively severe taxation of U.S. citizens and residents abroad inhibits our country's export trade and has resulted in loss of thousands of jobs abroad and in the United States because of our increasing inability to compete on overseas projects. This is especially true for those in sectors, such as construction, that are labor intensive and that base contract awards on relatively narrow profit margins. A review of some of the persuasive findings and other considerations follows.

. Export Trade

As early as the 1920s, it was evident to many that America's export of goods and services was significantly dependent on the presence of U.S personnel in foreign locations. Certainly now, as the United States has lost the overwhelming industrial and technological superiority once held, and as we find ourselves in the fifth consecutive year of trade deficits and declining competitive position, we must not ignore the fact that it is vital to encourage the presence of Americans abroad.

A Government Accounting Office report suggested that the United States could be losing up to $7 billion worth of exports a year solely as a result of our tax policies governing expatriate taxpayers, warning that the projections might well prove conservative. This loss, as well as worsening our balance of trade position, can be translated into loss of several hundreds of thousands of jobs a year for Americans.

As a specific example of this export drop, it has been reported that in the huge export market of Saudi Arabia, where five years ago the United States was the leading exporter, we have now slipped to third or fourth position. Senator Chafee recently summarized the export problem as follows: "What we gain from increasing exports is very simple --- more jobs for Americans here, and more tax revenue. For every one-billion dollar increase in exports, over 40,000 new jobs are created here, which in turn create $1 billion in increased corporate and individual tax revenues."

. Foreign Contract Competition

The margin of profit in many foreign contracts is not sufficient to permit a U.S. firm to assume the additional costs of the U.S. tax burden on expatriates. Of course, the foreign customer, with the option of choosing contractors from France, Germany, or Japan for the project, is also not willing to absorb these extra costs of using U.S. personnel. Therefore, the U.S. engineering/construction industry is forced into the position of replacing U.S. personnel with local or third-country nationals in an attempt to remain competitive. Unfortunately, many of the U.S. personnel who leave are in positions where they are directly involved either in purchasing decisions or in the design stage of contract work where purchasing specifications are decided upon. The loss of individual employment abroad is compounded by reduction in purchases of U.S. products and, ultimately, loss of jobs in the United States.

A private engineering, planning and research firm recently reported that American engineers and contractors have been able to sign up only approximately 10.3 percent of the more than $90 billion worth of Middle Eastern design and construction projects, even though the United States has about 40 percent of the worldwide engineering and construction capacity. Unless we are able to reduce the tax burden placed on U.S. employees of U.S. companies abroad engaged in competitive bidding with foreign companies, American companies will continue to fail to win contracts and the United States will not be able to benefit fully from the increased economic activity in the Middle East, the Eastern European and Asian markets, and the other developing countries.

. Comparative Trade Policies

In a recent report to the Speaker of the U.S. House of Representatives and the Chairman of the Senate Committee on Foreign Relations, President Carter discussed some of the various concepts of income tax jurisdiction. He observed that the United States is virtually unique in taxing income on the basis of residence, source, and citizenship. As a result of the U.S. jurisdictional policies and the absence of substantial relief provisions for our expatriate workers, America is the only major trading nation that taxes the income of its citizens while resident outside the home country.

This difference in taxation policy means that it costs more to maintain an American expatriate employee overseas than a local or third-country national employee. For the American employee to receive the same net pay as a competing foreign national, his gross pay package must be higher. Assuming the employer has the option to hire equally qualified persons, one of whom will cost more, he may hire a foreign national on the basis of cost. Usually, the company that does not hire Americans has far lower costs to recover and can be more competitive.

The President's Export Council, Subcommittee on Export Expansion, in its Report of the Task Force To Study the Tax Treatment of Americans Working Overseas (December 5, 1979), illustrated the effects of the anomaly of U.S. taxation of the earned income of its expatriates abroad with the following examples:

.. "Recruiting firms in France, Germany, Italy and the United Kingdom report they are swamped with requests for qualified citizens of their respective countries to replace Americans who are being forced home by U.S. tax policies.

.. "Several leading U.S. contractors in the Middle East have reduced their American staff by more than half and adopted hiring policies overseas that specifically exclude Americans on future work.

.. "The University of Petroleum and Minerals in Saudi Arabia says Americans now make up less than 30 percent of its teaching staff compared to more than 80 percent several years ago."

Senator Chafee reported earlier this year that a U.S. expatriate employee in Saudi Arabia earning a salary of $40,000 a year costs his employer $140,000 a year, including housing allowances and tax costs. A large U.S. company, with regional headquarters in Hong Kong, recently reported that non-executive salary costs were more than $40,000 a year higher for American expatriate employees there than for third-country nationals. Primarily because of U.S. tax costs, this company can hire three non-U.S. expatriates in Hong Kong for the cost of two American employees.

. Small Businesses

The United States is in obvious need of increased export sales for balance-of-trade considerations and for job creation here in the United States. A fertile source of such export sales and jobs can be the small businesses all over the country that currently serve only the domestic market. However, the additional costs of overseas operations can be a significant disincentive for entering the foreign markets. The U.S. tax rules for expatriates make the commencement of foreign operations by these smaller companies even more difficult, because often the local workers do not possess the U.S. know-how and familiarity with the smaller companies' operations.

. Taxpayer Compliance Complexities

Because of a substantial degree of needless complexity in applying the section 913, IRC, provisions brought about by the overly restrictive temporary regulations, taxpayer compliance with the law is quite difficult. It has been observed in recent months that even the tax professionals engaged by the taxpayers to assist them in preparing their U.S. income tax returns while they are abroad have had difficulty in dealing with the uncertainties surrounding compliance. As a result, the costs to the employees, and often to their employers, of compliance have risen at the same time that the relief provided has, in many cases, decreased. Effective taxpayer compliance and understanding of taxation provisions can best be encouraged by the drafting of clear and comprehensive legislation that places the U.S. expatriate on a competitive footing with third-country nationals.

. Training Considerations

An often overlooked but very important additional benefit of American employees working abroad is the valuable personal experience gained in handling international business situations. The personal relationships developed and local knowledge acquired cannot be duplicated in any other way. Future business managers need this kind of experience if they are to guide U.S. business in competitive international commerce.

LEGISLATIVE PROPOSALS

In response to the urgent need for enactment of a new law to place U.S. taxpayers abroad on the same taxation and competitive basis as citizens from competing industrial nations and, thus, help to reverse the significant reduction in the number of Americans working at foreign locations, three tax bills have been introduced in the Senate. Each of these bills would, in application, very likely reduce expatriates' tax burden from its present level, simplify compliance, encourage Americans presently overseas to remain, and promote the likelihood that others would consider foreign assignments. This is, in itself, a significantly positive benefit of such legislative changes. More importantly, however, the proposed legislation would reduce the costs of U.S. firms operating abroad, facilitate the winning of substantial foreign contracts, and, concomitantly, boost the American drive for increased export sales.

. S. 2283 - Introduced by Senator Chafee

Senator Chafee's bill to amend the tax statute with respect to the income tax treatment of earned income of citizens or residents of the United States earned abroad would, in summary, operate to:

.. Repeal the section 913, IRC, deduction for certain expenses of living abroad;

.. Amend section 911, IRC, to provide for an annual maximum foreign earned income exclusion of $50,000, increased to $65,000 for individuals who have already been bona fide residents of one or more foreign countries for a continous period of three years;

.. Amend section 911, IRC, to provide for an exclusion from gross income for the greater of the expatriate's housing allowance or housing costs in excess of 20 percent of earned income for the taxable year;

.. Provide that the $50,000/$65,000 exclusion would be allowed separately to married individuals both working overseas; and

.. Retain the current statute provision that foreign taxes attributable to excluded income are not creditable or deductible for U.S. income tax purposes.

This legislative proposal is a responsible effort at resolving the expatriates' excessive tax burden and simplifying compliance. The annual exclusion would significantly return expatriates in general to the tax posture existing over much of the period since the early 1920s legislation, provided that the level is high enough to compensate for inflation.

The provision for the housing deduction would, however, be more effective if, similar to the current section 913, IRC, housing deduction component, the deduction amount were to be computed as the excess of the greater of the housing allowance or costs over 20 percent of the earned income for the taxable year net of actual or imputed housing costs.

Further, to come closer to approximating the equivalent U.S. housing costs, the earned income should be reduced by any foreign tax reimbursement payments for the year. Otherwise, the housing deduction could, as in the case of individuals in Saudi Arabia, be severely diluted by these two elements and, therefore, be less beneficial.

It is not clear how the "election of prior law" (section 3(b)) is intended to apply.

. S. 2321 - Introduced by Senator Jepsen

Senator Jepsen's bill would, very simply, amend the tax statute to eliminate U.S. taxes on income earned by qualifying U.S. citizens working overseas. Senator Jepsen seeks this change as a matter of both equity and efficiency.

This forward-thinking and perhaps controversial position could well be the most effective long-range route to take. Certainly, it would place expatriate Americans on a similar taxation basis with those citizens of major industrial nations abroad with whom they compete. Additionally, it would relieve the I.R.S. of the multi-million dollar effort of administering the laws governing expatriate taxation.

The question of how large an earned income exclusion is appropriate for expatriate Americans is a difficult one. The enactment of lasting legislation by Congress requires a broad range of support. Many who would offer support in this effort may hesitate to agree to a provision for full exclusion of earned income abroad for the reasons outlined in the earlier section of this letter on legislative history. However, they may very well agree with a system with limits high enough to accomplish virtual full exclusion for most employees abroad, but at the same time preventing obvious abuses. In addition, it would seem that comprehensive legislation in this area must recognize the different overseas cost levels at various foreign work locations to be fully responsive to an equitable approach to expatriate taxation.

. S. 2418 - Introduced by Senator Bentsen

The legislation sponsored by Senator Bentsen to increase the competitiveness of American firms operating abroad and to help increase markets for U.S. exports is similar in approach to Senator Chafee's bill in providing that, in summary:

.. Section 911, IRC, would be amended to allow an earned income exclusion of up to $60,000 per year;

.. The current law provision for qualification for section 911 or 913, IRC, benefits by physical presence in a foreign country would be changed to a less restrictive 330 full days out of any period of 12 consecutive months;

.. The rules for individuals housed abroad in camps would be simplified;

.. Section 913, IRC, would be amended to allow a deduction only for qualified housing expenses. Lavish or extravagant expenses would not be allowed, and only those expenses exceeding the individual's base housing amount would be allowed as a deduction. The base housing amount would simply be computed as 16 percent of the salary of a U.S. employee whose salary grade is step 1 of grade GS-14;

.. The qualification provisions could be waived if certain adverse conditions required that the individuals leave the foreign country;

.. An individual choosing to elect the exclusion would not be allowed, as a deduction or a credit, any foreign taxes properly allocable to the amounts excluded from gross income.

The legislative solution offered by Senator Bentsen would appear to result in a simplified statute that provides U.S. expatriates, and thus their employers, with a more equitable tax treatment. The proposed physical-presence qualification period is somewhat similar to that used by many competing foreign trading nations. Certainly, if the "camp rules" are to accomplish what was intended when they were enacted as section 911, IRC, in 1978, rule simplification is required. Additionally, the statute should be flexible enough to accommodate taxpayer situations such as those experienced by Americans who had to flee Iran.

The housing deduction limitation proposed by the Senator would clearly be less complex than one calculated on the earned income, after adjustments, of each taxpayer. Also, there would be precedent for using the income level of a step 1, grade GS-14 U.S. Government employee as a standard for the base housing amount as such an income level has been used for other section 911 and 913, IRC, measurement purposes.

It is not clear how the deductions allowed by section 217, IRC, (relating to moving expenses), would apply in connection with the foreign taxes paid on the excluded income. This may be a drafting oversight.

It must be observed that, although a comprehensive effort at expatriate tax reform, the Senator's bill would not provide for the fluctuation of the benefits provided with the actual cost circumstances abroad, other than those reflected in the housing deduction.

RECOMMENDATIONS

Our recommendations are based upon certain principal goals that we believe this legislation should seek to achieve.

- Amounts needed to pay additional living expenses to maintain a comparable standard of living abroad should not be taxed. These amounts are not compensatory and confer no economic benefit upon the expatriate employee.

- The excessively high costs of American companies doing business overseas resulting from the expatriate taxation provisions should be reduced. This would improve the competitive position of American businesses overseas.
- There should not be a disincentive for American workers to accept overseas assignments. Rather, studies indicate that incentives are needed. Americans would then be in more positions of influence in the overseas business community, and that would increase American exports and contracts abroad.
- Rules affecting tax returns of Americans overseas should be less complex.

The unlimited exclusion proposed by Senator Jepsen (S. 2321) would accomplish all of those goals. However, because the possibility may exist for abuse under those provisions and because widespread Congressional support may be difficult to obtain, we believe that another approach would be better.

We believe that the above goals could be substantially met by legislation that includes a series of specific, easily determinable deductions related to particular additional foreign living costs, together with an earned income exclusion of a fixed dollar amount.

. **Additional Living Costs**

Section 913, IRC, and particularly the temporary regulations thereunder are needlessly complex and overly restrictive. These rules should be changed. Nevertheless, we believe that the legislation should recognize that additional living costs vary from place to place around the world and in different situations.

The cost of housing is, in most instances, the largest additional living cost, and one that varies the most from situation to situation. We believe that the allowance to pay for housing and the value of housing provided by an employer should not be included in taxable income, except for an amount representing housing costs that the employee would bear in the United States. In this connection, we believe that the "base housing amount" calculation proposed by Senator Bentsen (S. 2418) is preferable because it offers a simple calculation and a realistic result.

There are other additional living expenses, such as home leave costs, educational costs, and general "market basket" living costs, that vary considerably from situation to situation. Amounts required to pay these expenses should not be included in taxable income, to the extent they are reasonable in amount.

It is particularly important that the legislation be as free of complexities as possible and still provide equity among Americans working abroad.

. Cost Reduction for American Business Operating Abroad

The inordinately high tax burden on Americans working overseas is borne, for the most part, by employers. This results in extremely high employment costs for U.S. businesses sending Americans abroad, putting them at a competitive disadvantage as compared to businesses from competing nations. As pointed out by the President's Export Council Report of December 5, 1979, even if the existing tax provisions were to operate in the least restrictive way possible it remains clear that U.S. citizens and residents overseas would not be in a competitive position with nationals from other countries in terms of taxes. This would also be true if the recommendations for living expenses discussed above were implemented. Therefore, we think it is appropriate to provide a reasonable earned income exclusion, in addition to the deductions for excess living costs discussed above, to further reduce the higher costs now being borne by U.S. businesses.

Many of our trading partners abroad, particularly other members of the General Agreement on Tariffs and Trade, have criticized U.S. tax policies for promoting exports. Those countries do not tax the income earned by their nationals residing abroad. They thereby enhance the competitive position of their companies and increase their chances of expanding foreign contracts. Yet, we fail to utilize this same measure to promote exports, even though those who are critical of some of our policies could not disapprove.

We believe, therefore, that the earned income exclusion should be set at a level high enough to exclude the employment earnings of most U.S. citizens and residents employed abroad. The amount of the exclusion should be adjusted from time to time as inflationary pressures cause salaries to increase.

The exclusion should be allowed to both working spouses, as under prior law, in order to avoid a disincentive for working couples to go abroad.

. Incentives for Overseas Employment

The amount of the earned income exclusion should be set at an amount high enough not only to eliminate additional taxes on Americans working abroad (and resulting higher employment costs), but also to result in a reduction in the individual employee's personal tax burden. This would provide an incentive for Americans to accept overseas assignments.

. Other Considerations

We strongly urge the subcommittee to be sensitive to the effects upon expatriates and their employers of the timing any significant changes. Twice in recent years (in 1977 and 1978) taxpayers were faced with approaching filing deadlines while the rules affecting their tax returns were still in the making. Partial relief in the form of extended deadlines came only at the eleventh hour, and that was too late to alleviate the administrative burden.

We emphasize that this situation resulted in extremely high costs -- needlessly -- for the preparation of income tax returns.

The legislation should be clear and complete enough so that legislatively mandated regulations would not be required. This would help to prevent recurrence of the difficulties caused by the temporary regulations under section 913, IRC.

We would be pleased to discuss these comments further with representatives of the Subcommittee. If further information or discussion would be helpful, please telephone Mr. David F. Bertrand, (212) 790-0533, Mr. L. W. (Pete) Linch (212) 790-0535, or Mr. Alexander Zakupowsky, Jr., (202) 862-3520.

Respectfully,

Deloitte Haskins & Sells

WHO REPRESENTS AMERICANS ABROAD?

–SANFORD G. HENRY–

INTRODUCTION

There is a new American frontier: the world. U.S. multinational corporations offer trade throughout the world, from Paris to Peking, bringing American business methods with them.

As an export nation the United States is the largest exporter of goods and services in the world. According to estimates the U.S. multinational corporations produce one third of the gross *world* product. Multinational companies have invested nearly $200 billion outside the U.S., and control assets of nearly $500 billion.

On the importing side, the United States is dependent on imports. Of the eighteen major minerals*, the U.S. imports more than 50% of thirteen of them and 100% of its tin, chrome and manganese. The United States imports 40% of its oil.

In 1940 the United States direct foreign investment amounted to about $7 billion; since the Second World War the investment has grown from $12 billion in 1950, to $78 billion in 1970, and nearly $119 billion in 1974. In 1978 the investment figure was an astounding $164 billion!

With the international expansion has come an American colonialization. There are an estimated two million Americans living abroad. The American way of life and influence has been extended beyond the business methods described by Jean-Jacques Servan-Schreiber in his book *The American Challenge* to produce a new kind of American. This American has had to adapt to the environment of a different country and has become a 'citizen diplomat' representing the United States abroad.

This book will urge that Americans who support the growing U.S. international presence abroad should have their full rights as citizens. Whether working for I.B.M. or for BECHTEL, in Brazil or in Nigeria, these Americans deserve all aspects of citizenship including the right of real representation!

* see Appendix I

I HISTORY REPEATS ITSELF?

1. NO TAXATION WITHOUT REPRESENTATION

More than two hundred years ago, as a prelude to the creation of the United States of America, there was a cry of 'No Taxation Without Representation'. This historical cry of yesterday has an audience today: American citizens living abroad.

The war between Britain and her American colonies which followed the cry was fought around many issues, with the question of representation clearly a key issue. The fight to secure the right of representation culminated when independence was achieved by the original thirteen colonies to form the base of what is today the United States of America. Nothing could be more steeped in American liberal democratic tradition than the hue and cry of 'taxation without representation'. This cry could today become the focal point for a different kind of revolution, another group seeking representation.

The thoughts and ideas about representation expressed in this book are not intended to be definitive. Rather the intention is to draw upon the historical past in order to show reasons why there should be representation for United States citizens living abroad. The ultimate aim of the book is to compel the United States Congress first to understand the issue, and secondly to propose positive action for representation. This book will suggest that only through representation in the United States Congress will the Government be able to address itself clearly to the problems of citizens living outside the U.S. These citizens have today become alienated and disenfranchised from the American democratic process; there is a case for representation, now!

The ideal is representation; the reality is to define the representation issue and provide supporting information. It should be understood that only through participation by representation will U.S. citizens living abroad have a voice in their own government. Representation means having someone within government who speaks for the special issues and unique problems which affect these citizens, their future lives and the lives of their families.

2. HISTORICAL PERSPECTIVE

Let us go back to a time when America was a mixture of thirteen colonies under British rule, and in the process discuss the origins of the taxation and representation issue.

While the issue may have been new to our revolutionary forefathers, it was old to the British people. It evolved throughout the course of British history, and representation was one of the principal rights demanded in the Magna Carta. The Magna Carta was, as Churchill noted, 'a redress of feudal grievances extorted from an unwilling king by a discontented ruling class insisting on its privileges.' Its effect was to establish a supreme rule of law to which men could turn beyond regal authority. Laws were to be determined through representatives, in this case from the baronial classes. The taxation issue was first raised in England in 1637 against Charles I, and it was then established that neither the King nor his ministers could levy a tax without first obtaining the consent of Parliament. The American view was more grassroots than the British: the colonies felt that only an assembly elected by those to be taxed could exercise such power.

The debate continued in the eighteenth century since all British subjects (Scottish and Irish being the most vocal) did not have full representation in Parliament. Lord Mansfield, Chief Justice of the King's Bench, told the House of Lords in 1766:

> There can be no doubt, my Lords, but that the inhabitants of the colonies are as much represented in Parliament as the greatest part of the people of England are represented: among nine millions of whom there are eight which have no vote in electing members of Parliament . . . A member of Parliament chosen for any borough represents not only the constituents and inhabitants of that particular place, but he represents . . . all the other commons of this land, and the inhabitants of all the colonies and dominions of Great Britain.

The objections of The British Subjects were based on the fact that, although they had been required to pay tax to the Crown, they had no voice in Parliament. This inequity was dismissed by the majority of Members of Parliament at the time, since representation in British Parliament was not viewed as representation of men. Rather, Parliament represented 'estates' – groups such as lawyers, doctors, commercial classes, landed gentry – and hence, the British argued, Ireland and the Colonies had as much representation as many other Englishmen.

In Britain, it was only after the United States rebellion that the principle of representation for the British Isles was more thoroughly debated. Yet, despite the American experience, it was not accepted into law. It was, in fact, more than two centuries before full representation for all citizens was achieved.*

* As recently as 1912, Mrs Pankhurst spoke on trial as an accused protester and demonstrator for the right of women's votes in the U.K.: 'If I had the rights that you possess . . . a share in electing those who make the laws I have to obey . . . a voice in controlling the taxes I am called upon to pay, I should not be standing here.'

3. THE REVOLUTIONARY ISSUE

In the Colonies, during the late 1700s and especially following the end of the Seven Years' War, the British war debt was high. During the period directly following the war the British national debt was about £130 million, with yearly interest of some £4 million, and Parliament determined that new sources of taxation had to be found. What more logical place than from Britain's Colonies? At the time the Colonies produced substantial income for the British Government. The American colonies were particularly useful, providing a market for some 35% of Britain's exports and 38% of the Colonies' imported goods. But imposing taxation on the American colonies in order to raise revenue for the British Government was potentially very dangerous. Not only would taxation of the colonies create a precedent, but it required special tax legislation, subsequently proposed in the form of Parliamentary Acts. These Acts, passed by Parliament, were the Sugar and Stamp Acts.

Besides producing revenue, the Sugar Act of 1764 was a trade measure: it reduced by half the foreign-produced molasses imported into the Colonies and raised the duty on foreign rum. By these means the Government sought to stimulate the economy of the British West Indies, at that time facing competition from other foreign sugar islands, and to defray the costs of maintaining the military which protected the colonial frontiers. The Sugar Act was followed by the Stamp Act of 1765. This legislation placed a tax on all newspapers, pamphlets, legal documents, licences, and even dice and playing cards. With receipts from these two taxes, Parliament intended to reduce costs incurred in maintaining defences in North America, and also to provide income for the Crown, enabling it to reduce its overseas debt.

While the Sugar Act affected only small trading groups such as importers and distillers, the Stamp Act touched all inhabitants of the Colonies directly or indirectly, and succeeded in arousing objections from virtually all the American colonies. It was the first direct tax Parliament had ever tried to levy in America, and for someone interested in designing a tax to please none of the people all of the time it was almost perfect. Not only did it create hostility among the loyal colonists but it inspired the revolutionary elements. More generally it raised a constitutional philosophical point which was considered highly questionable by many within Parliament itself, and a debate began in the Houses of Parliament. William Pitt said of the Stamp Act that, in his opinion, 'This kingdom has no right to lay a tax upon the colonies.' Edmund Burke more eloquently voiced the colonialists' cause:

> America being neither really nor virtually represented in Westminster cannot be held legally or constitutionally or reasonably subject to obedience to any money bill of this kingdom . . . In every other point of legislation the authority of Parliament is like the north star, fixed for the reciprocal benefit of the parent country and her colonies. The British Parliament has always bound them by her laws, by her regulations of their trade and industries, and even in a more absolute interdiction of both . . . if this power were denied I would not permit them to manufacture a lock of wool, or a horseshoe, or a hob-nail. But, I repeat, this House has no right to lay an internal tax upon America.

On the American side the colonies of New York, Massachusetts, Pennsylvania and Virginia began to debate the authority of Parliament to impose such measures. The joint committee of the Massachusetts Legislature wrote in 1762:

> Our political or Civil Rights will be best understood by beginning at the Foundation . . . The Liberty of all Men in society is to be under no other legislative power but that established by Consent in the Commonwealth, nor under the Dominion of any Will or Restraint of any Law, but

> what such legislation shall enact, according to the trust put in it.

The successful struggle against arbitrary rule in England, from the grant of Magna Carta to the Revolution (of 1688), had established the liberty of British subjects not merely in England but throughout the empire as a whole, since the Committee continued:

> No reason can be given why a man should be abridged in his Liberty, by removing from Europe to America, any more than by his removing from London to Dover, or from one side of a street to the other. So long as he remains a British Subject, so long must he be entitled to all the privileges of such one: Frenchman, Portugals, and Spaniards are no greater Slaves abroad than at home, and by Analogy Britains should be as free on one side of the Atlantic as on the other.
>
> Colonialists have a right to be free from all taxes but what he consents to in person, or by his representative . . . is part of a British subject's birthright, and as inherent and perpetual as the duty of allegiance.

The political repercussions were infinitely greater than the tax amounts to be raised. Colonial opposition to taxation was ignited; this time it was leading down the road to revolution and eventual American independence.

Thomas Paine's *Common Sense* argued:

> The powers of governing still remaining in the hands of the king, he will have a negative voice over the whole legislation of this continent. And as he hath shewn himself such an inveterate enemy to liberty, and discovered such a thirst for arbitrary power – is he or is he not, a proper man to say to these colonies, 'You shall make no laws but what I please.' And is there any inhabitants in America so ignorant, as not to know, that according to what is called the present constitution, that this continent can make no

> laws but what the king gives leave to; and is there any man so unwise, as not to see, that (considering what has happened) he will suffer no Law to be made here, but such as suit his purpose. We may be as effectually enslaved by the want of laws in America, as by submitting to laws made for us in England.

The rest becomes a verbal collage of American historical moments: the First Continental Congress; the battles of Concord and Lexington; the cry of 'Give me liberty or give me death'; a Washington at Valley Forge. Finally, the surrender by Cornwallis of British forces at Yorktown meant independence for the soon-to-be-formed United States of America. As the issue 'Taxation Without Representation' had sought to find its solution through a war for independence, the Constitution embodied the principle of representation for ever.

II WHO QUALIFIES FOR REPRESENTATION?

1. REPRESENTATION

Webster's Dictionary defines 'to represent' as 'to serve', especially in a legislative body, by delegative authority usually resulting from an election.

The great English writers of the seventeenth century, in particular John Locke in his essay *On Civil Government*, provided the origins for American representative government through the philosophy of natural law. The U.S. Constitution was influenced by Locke and is primarily a natural law document. 'By natural law' means that the power of government was granted only on trust by the people to the rulers, and any infringement or violation by the rulers entitled the people to re-assume their own authority. The origin of this concept emerged after the Renaissance, but Locke was the English father of the natural law theory.

Thomas Paine, pensman of the Revolution, was heavily influenced by the writings of Locke. He said of government:

> Every man is a proprietor in government, and considers it a necessary part of his business to understand. It concerns his interest, because it affects his property. He examines the cost, and compares it with the advantages – and above all, he does not adopt the slavish custom of following what in other governments are called LEADERS.

Through this representative legislative process the individual is able to elect delegates who participate in the enactment of laws and thereby have a say in the various stages of the governmental decision process.

Representation in government was a focal point for the colonies in America who objected to 'Taxation Without Representation'. The issue was a key factor in the American War for Independence, and victory gave the colonies themselves the right to elect a representative parliament which would be the taxing authority. The right of taxation, therefore, passed from the Crown to a representative body. With this representation and the power of the ballot box, an individual would agree to follow the direction of an elected governing body. If decisions were taken against his wishes, he could speak to or vote against such a representative body until his view was heard or another representative body elected.

Representation may not be the only way of seeking change or governmental action, but in a democracy it is the principal way an individual can inform the government of his opinion or point of view. While this flow of information is important to the individual, it is also essential for government if it is to evaluate the current and specific interests of the constituencies it represents. As J. R. Ducas puts it in *Democracy and Participation:* 'Only the wearer knows where the shoe pinches and only the governed can say how the activities of Government bear on the value they care about most.' This participation or representation is a demand for a voice to be heard within the decision-making process. J.S. Mill in *Representative Government* carries this point a moral step further by saying that participation and representation are based on the good effect they have on the individuals who participate.

In a democracy the vote is usually the reflection of the individual's participation; it enfranchises him as a citizen, and allows him the possibility of stating his view either directly through the ballot box on issues that affect his own day-to-day life, or through a vote for the representative of his choice. It also allows him to take political initiative on issues that he feels are important and allows him to have a citizen's participation on issues which may influence his future and that of his family.

In the course of British history, the supreme power of Parliament has been accepted and developed primarily through the acceptance of the Magna Carta; in the United States, partly because of the British heritage and partly as a result of the American Revolution, the constitution defines the role of Congress, which in turn is elected to serve a defined constituency. This form of representative government has become standard and has served to influence democratic political institutions in other countries of the world. Today, parliaments which largely originated from the King's need to communicate with his subjects and mobilise their support for his policy, have become the voices of the subjects themselves.

2. TAXATION: A CASE IN POINT

The United States is the only major industrialized country which taxes its citizens on a world-wide basis rather than on the basis of residency. The Sixteenth Amendment of the U.S. Constitution states: 'The Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.' The amendment has always been interpreted so as to allow the United States government to tax its citizens regardless of their residence. Proposed in 1909 and ratified by a three-fourths majority of the States in 1913, it has also served as the basis for justifying taxation of U.S. citizens living abroad. The constitutional basis for this principle of taxation of U.S. citizens living abroad and Treasury's interpretation of it was reaffirmed by Congress in 1924. More recently, changes to the Internal Revenue Code have been adopted to 'keep up with the changing times'. The first change came in 1963 when U.S. citizens living abroad were granted tax exemption on foreign earned income. Since then Congress has passed various exemptions on earned income of Americans abroad, essentially 'to help our foreign trade and to put all Americans who are working abroad in a position of equality with their competitors. . .' These rulings have varied from complete exclusion of earned income to specific exemptions ranging from $20,000 to $25,000. The tax incentive was designed to encourage Americans to live and work abroad. This was the situation until the most recent vast change: the Tax Reform Bill of 1976. Immediately prior to the Tax Reform Act of 1976:

> U.S. citizens were generally taxed by the U.S. on their world-wide income with the allowance of a foreign tax credit for foreign tax paid. However, under prior law U.S. citizens who were working abroad could exclude up to $20,000 of income earned during a period in which they were present in a foreign country for 17 out of 18 months or during a period in which they were bona fide residents of a foreign country (sec.911). In the case of individuals who had been bona fide residents of foreign countries for three years or more, the exclusion was increased to $25,000 of earned income.

The Tax Reform Act of 1976 reduced the earned income exclusion for individuals working abroad to $15,000 per year*. It also more technically said the following:

> First, the Act provides that any individual entitled to the earned income exclusion is not to be allowed a foreign tax credit with respect to foreign taxes allocable to the amounts that are excluded from gross income under the earned income exclusion. Thus, foreign income taxes that are paid on excluded amount are not to be creditable or deductable.

* Thomas E. Johnson's *A Practical Guide to U.S. Taxation of Overseas Americans* provides an in-depth practical analysis of the complicated Tax Reform Act 1976.

> **Second**, the Act provides that any additional income derived by individuals beyond the income eligible for the earned income exclusion is subject to U.S. tax at the higher rate brackets which would apply if the excluded earned income were not so excluded.
>
> **Third**, the Act makes ineligible for the exclusion any income earned abroad which is received outside the country in which earned if one of the purposes of receiving such income outside of the country is to avoid tax in that country.

If that became confusing (it did) and objectionable (completely) to many U.S. citizens abroad, new laws under the Foreign Earned Income Act of 1978 were even more so. This Act delayed the implementation of the Tax Reform Act of 1976, allowing U.S. citizens the benefit of the old law for 1977, and permitting U.S. citizens, for tax returns in 1978, to choose between the provisions of the 1976 Act or the 'benefits' of a new law. This new law allows U.S. citizens to itemize certain 'quantifiable' deductions for 'excess foreign living costs' and created new confusions in an already complex tax treatment. If Congress was trying to tell people to stay in Nebraska, the new provisions which applied to U.S. citizens living abroad could hardly have been more of an inducement. Imagine the joy of U.S. citizens abroad reading even a summary of the Tax Treatment Extension Act of 1978 (most of which unfortunately was not passed by Congress):

> The bill, as amended, extends the effective date of several provisions dealt with in the Tax Reform Act of 1976 and generally prohibits the Treasury Department (Internal Revenue Service) from issuing certain rulings or regulations effective prior to specific dates in 1978.
>
> The effective dates of the following provisions are extended by the Bill:

(1) the pre-1976 Act exclusion for Section 911 (income earned abroad exclusion) is extended for two years, or until January 1, 1979;

(2) the current treatment of salary reduction, etc., pension plans is extended for two years, or until January 1, 1980;

(3) the effective dates of the net operating loss rules adopted in the 1976 Act are extended for two years; and

(4) the effective date for the tax treatment of State legislator travel expenses away from home is extended for one additional year, that is, for years beginning before January 1, 1978.

So what does this background in representation tell us in relation to the specific case of taxation of U.S. citizens living outside the United States?

It should be pointed out that while representation can be defined in theory, it does not apply to this practical case. Despite lobbying efforts on the part of citizens' groups, tax laws have been imposed without the advice and consent of the affected citizens.

III AN AMERICAN CHALLENGE

1. EXPATRIATES IN A CHANGING WORLD

The dictionary defines expatriate as: 'to leave one's own country, 1: to drive into exile: banish 2: to withdraw (oneself) from residence in or allegiance to one's native country – to leave one's native country: to renounce allegiance to one's native country'. But what is the American expatriate today and his role versus the early 1900s?

The role of America in world affairs has changed dramatically since the turn of the century. The United States has emerged from being a secondary power into being one of the greatest economic and political forces in the world. It has been a major factor in international trade, as evidenced by the growth of the multinational corporations. America continues to become increasingly international whether or not the American people actually recognize it. More specifically:

- one out of every eight jobs in the U.S. domestic manufacturing sector depends upon exports;
- nearly ten million domestic jobs in the U.S. depend on U.S. exports;
- one out of every three dollars of U.S. corporate profits is derived from international activities.

Economically and politically the world is becoming smaller not larger, and the United States, as one of the prime world leaders, has to become a society increasingly influenced by global issues. This presents America with an even greater responsibility: that of looking at international as well as domestic issues. McGeorge Bundy puts this struggle of America against international behaviour in historical perspective:

> The American society puts private before public purposes. The politics of our country still begin with the individual, not the state. Our tests of ourselves as a good or not so good society, relate to the human conditions of our citizens. Our political principles begin with the rights of man, and it was not manifest destiny or imperial ambition, or any accepted priority for the interest of the state, that brought us as far into the world as we have come. It was rather a combination of perceived danger and an exuberant non-governmental expansion of particular interests. Both have had enormous impact on our behaviour and on the level of our engagement – neither has changed the fundamental political priorities of our people.
>
> Thus it is an elemental fact of our political life that most of our national elections – and 1976 was surely no exception – do not turn on issues of foreign policy. Such issues are always present and often hotly debated, but they are rarely decisive. An unpopular war can work strongly against the party in power, as in 1952 and 1968. A candidate who is perceived dangerously hard (Goldwater) or soft (McGovern) can lose heavily from the perception. But most voters, most of the time, are moved by issues that are closer to home.

If the American public is to become more internationally aware, what issues could more dramatically point to this global interdependence than the international decline of the dollar or the OPEC-sponsored oil crisis of 1973? On the dollar issue, recent U.S. balance-of-payments deficits and the declining dollar are definite warning signals which will continue in the future. The rapidly depreciating dollar and persistent trade deficits with certain industrializing countries show the United States is no longer free to pursue economic policies with internal rather than external considerations in mind. Indeed, they are symptomatic of the U.S. need to co-ordinate economic policies with those of other large industrialized countries. The OPEC oil-pricing issue, particularly in 1973, showed the interdependence of the United States and its partners throughout the world on international trade. In contrast, a report released recently in the United States by the Chicago Council of Foreign Relations showed that only 11% of the American public and only 23% of those with a university education perceived energy as a major problem. At the same time, inflation – in which higher oil prices will inevitably be a major factor – is seen as by far the biggest U.S. concern, both to the general public and to the university educated, overtaking in importance foreign policy, social policy and other aspects of the economy. The U.S. Congress has gone further in pointing out the danger; Congressional committees have stated that the U.S. economy may be crippled by fuel shortages and the high cost of oil for the next twenty years.

Is there a greater interdependence? Are international issues more important today? For the answer, ask the Michigan industrialist or the Iowa farmer. While both recognize the 'effect' on the domestic economy, perhaps they are unaware of the international 'cause'.

There are other international influences on American society besides the oil and monetary issues. The multinational corporation is one; in addition to governmental forces it has been a force in internationalizing the American 'Way of Life'. Lee Morgan, President of Caterpillar Tractor Company, emphasised the importance of the multinational corporation:

> One of the dominant forces contributing to the postwar revolution in human achievement and expectations has been the growth of the multinational business. We should therefore recognise that present-day concern over our business activities is predictable, if for no other reason

> than that the impact of the production, supply, and distribution of goods on an international scale has never been as great as it is today.
>
> Multinational corporations perform over 25 per cent of the world's production of goods and services. U.S. based multinationals are involved in about 60 per cent of this total.
>
> Even though the bulk of this activity takes place in the developed world, it is of such widespread impact that the developing nations rightly identify multinational business as the key to their own prospects for economic betterment. The problem has arisen where they decided that perhaps another sort of key would serve as well.
>
> As it is, our world is changing in ways few of us would have predicted just a quarter century ago. For example, how many of us in 1950 could imagine that the people of the United States would be so dramatically affected as we are today by what is happening in the deserts of the Arabian peninsula, by the empty stomachs of the people in the Sahel region of Africa, and by the changed ownership of the copper-rich mountains of Peru.

The 'multinational corporation' label sounds ominous. But familiar names like Exxon, Citicorp, Colgate-Palmolive and Coca-Cola are reassuring and less frightening. These and other U.S. multinational corporations operate (about $515 billion in sales) and earn income (approximately $25 billion in 1978 alone) throughout the world.*

Given these new forces affecting the United States, it would seem that the United States should, in fact, be more aware of international affairs. What better way than to encourage and support U.S. citizens living abroad? This encouragement would internationalize the United States from the outside as well as from within. It may one day lead toward a more integrated world of Americans, Europeans, Africans and Asians. The need to survive is of common interest, and both geopolitically and economically co-operation is now no longer just a hope, it is a necessity.

---

* see Appendix IV for other U.S. multinational companies.

2. WHO ANSWERS THE QUESTIONS?

Currently, there are over two million Americans living outside the United States. This number exceeds the population of some fourteen individual states in the U.S.; in fact, the number is larger than the population of three of the smallest states combined. This represents a very large constituency.

Let us look more specifically at the political needs of these citizens, employees of U.S. companies, students, military personnel and others who live abroad representing the United States either directly or indirectly. These are people who have not denied their country's citizenship but are merely living abroad. Do they currently have representation in Congress? What form does that representation take? Today, an individual living outside the United States is represented by the Congressman in his district of previous registration, if any. If he has problems that involve the use of representation in the Congress he can, in theory, write to that representative who will then act for him in Congress. Is it fair, therefore, to say that individuals who live outside the United States are not adequately represented? Is the local Congressman interested in finding the answer to the following questions?

- **Different citizenship rights for children of U.S. citizens born or living abroad?**

In 1977 39,304 births were recorded by consular officials. In order for these new citizens to maintain their birthright the government imposes conditions: minimum residency requirement for either child or parent.

– Taxation of U.S. citizens living abroad?
Changing and complex laws unfairly tax and burden these citizens, unlike the laws of any other nation.

– Voting rights of U.S. citizens living abroad?
Despite the recently passed Overseas Citizens Voting Rights Act of 1975 which, for the first time, granted the fundamental right to vote to overseas citizens, problems are in evidence. Complexities of registration and lack of uniformity create confusion, while information on how to vote remains a government secret.

– Taxation treaties between the U.S. and other countries and their effect on individuals living abroad?
Recent negotiations between French and U.S. authorities created misunderstandings on world-wide double taxation for which there were only citizens' groups to provide information.

– Federal legislation information related to military Veterans' benefits, retirement and social security changes?
Recently, a U.S. citizens' group in Europe had to fight to obtain an extension of medical benefits abroad which should have been previously available.*

The local Congressman is probably not interested in the answer to these and other questions. In fact, he is probably, and logically, more interested in the needs and wants of his local, domestic constituency than he is in the U.S. citizen living abroad. While well-intentioned in terms of understanding that there is a need for U.S. citizens living abroad to have their questions answered, he knows these citizens do not represent a large majority in his constituency but rather a small, insignificant minority; in practical terms, in the local Congressman's view, they do not represent voting strength or help in terms of re-election. The priority and expertise in answering questions such as those above is, therefore, low among Congressmen who, whether they like it or not, represent U.S. citizens living abroad.

---

* American Citizens Abroad, A Geneva based organization, presented some fifty such issues affecting U.S. citizens abroad to the President of the United States on 18 December, 1978 (see Congressional Record, 23 January, 1979).

If not to the Congressman who is unfamiliar with these issues, to whom does the U.S. citizen abroad turn for information on questions related to living abroad? United States embassies in many countries provide personnel to answer the individual's questions on a when-asked basis. They do not, however, seek out U.S. citizens in order to provide them with information that may affect their lives. A new law enacted may provide increased social security benefits for the aged, or new voting procedures for electing officials may be instituted – these are just small issues that may affect the individual living abroad; an embassy may provide the information, but it is not obliged to do so as part of its responsibilities in the country in which it is located.

Do embassy personnel provide objective information? Embassy personnel are employed by the Government. Therefore, if a point of view is formed which is not in line with the Government's policy, it would certainly not be pointed out to an individual. In addition, the governmental administration is certainly not geared to handle constituents' questions. Often, on tax and legal matters, U.S. citizens living abroad must seek expensive international tax or legal advice in order to obtain objective answers for their own use and to their own satisfaction.

3. ISSUE: AN EXAMPLE

And what of taxation? By the ill-fated Tax Reform Act of 1976, each individual in the United States was required to pay taxes to the United States Government for earned income from abroad in excess of $15,000. This requirement was amended in 1978 by the Foreign Earned Income Act. Both acts were passed by Congress and affected U.S. citizens living abroad who had no real voice in their consideration.

An example of how the recent legislation would treat tax changes and deductions should be shown; a calculation considering a married taxpayer with two children living in France would be as follows: assuming a base salary of $30,000, a cost-of-living allowance of $4,600, a housing allowance of $9,000, an education allowance of $4,200, and a home-leave allowance of $2,000, the taxpayer finds, adding these figures, that his total earned income is $49,800. Looking at the table provided by the I.R.S. he finds that France is a country in area 'H' and the deduction for a family of four in an area 'H' country is $4,600. He has spent his full allowances for education, home leave and housing. To find his base housing amount, he adds his cost-of-living deduction and his education, home leave and housing costs, making $19,800 and subtracts this from the total earned income of $49,800 leaving $30,000. He takes 20% of $30,000 (or $6,000) for his base housing amount. To find his housing deduction, he subtracts the base amount from his housing costs, getting $3,000. He now totals his deductions for housing, cost of living, education and home leave – $3,000 + $4,600 + $4,200 + $2,000 – getting $13,800. Subtracting this from his earned income, he finds he has a taxable income of $36,000 and before foreign tax credit his U.S. income tax is $7,632. If he pays $6,225 in French income tax, which is credited dollar-for-dollar against U.S. income taxes, under the new law he would owe $1,407. Under the old law he would owe nothing, his U.S. tax before foreign-tax credit of $5,360 ($3,815 for those abroad for more than three years) being totally offset. On the other hand, under the Tax Reform Act of 1976, he would have owed about $4,600 in U.S. income taxes (see Appendix V for further details).

These taxes, which are complex and changing, are based on U.S. citizenship and not on residency. In effect, they do not allow the individual – unless he happens to be in the United States – to utilise the facilities that his taxed dollars are being used to pay for. In other words, the only way that the U.S. citizen living abroad can obtain the benefits of the taxes he pays is to return to the United States. Does this seem fair to U.S. citizens living abroad? Are these citizens being taxed thus and still not allowed adequate representation in a Congress which passes laws to change their lives and alter their incomes?

4. TOMORROW'S ANSWERS

What are the possible steps to be taken towards achieving representation for U.S. citizens living abroad?

First and foremost, there could be a constitutional amendment allowing for a directly elected legislator to represent U.S. citizens abroad.

Secondly, there could be congressional representatives similar to the non-voting delegates currently acting for American citizens living in Guam, the Virgin Islands and Washington, D.C.

Thirdly, there could be a solution based on the French system. In countries such as France (Italy and Portugal are others) there are special members of the National Parliament who have been designated to represent nationals living abroad. In France the legislation is quite clear and could be used as a beginning: the Assembly General has created a committee of six members of the Senate to represent individuals living outside France. The aim of the committee is to discuss and provide solutions to questions of education, social security, legal immunization etc. in order to make 'the living conditions of French people abroad as much like those of people living in France itself'. The committee discusses problems affecting citizens outside France and brings the issues to the attention of the Assembly as a whole. Offices abroad, which have been set up by the French Government, enable individuals to express their views and receive information on new legislation passed by the Assembly General. Senators are thus appointed to act on behalf of French citizens living ouside France.

The benefit of such representatives is clear. A similar system in America would provide U.S. citizens abroad with a focal point for contact with the legislature. It would, more importantly, create a source of information about expatriate problems – and hopefully serve to find solutions!

Would not a system of representation make sense for U.S. citizens abroad? Would this not give citizens abroad a voice in Congress in order to propose such legislation as revised taxation of citizens abroad? Would there not be more accountability and a chance for citizens outside the United States to participate in the legislative process? Would it not also give them an opportunity to lobby from within rather than looking from the outside upon legislation that affects their lives and their livelihood? Is there not an adequate constituency, given the number of Americans living outside the United States, to justify this kind of approach to representation? Is there not enough international-mindedness in the United States to see the direct and indirect benefits from those U.S. citizens living abroad who continue to perform a vital function for their country through trade, commerce, goodwill and representation of the American 'way of life'?

CONCLUSION

I have not endorsed a Boston Tea Party and I have not suggested that United States citizens living abroad should refuse to pay taxes until these grievances have been resolved. I speak to identify the issue of representation for the many thousands of U.S. citizens living abroad. I speak as a voice of concern and urge fair consideration by the Administration or Congress for these individuals who need representation in the Congress.

The Congress, which has the right to pass laws affecting the everyday lives of these citizens, does not seek the advice and c consent of the constituents affected. Representation would change that situation!

These expatriates are not vagabonds trying to escape the American system. They are conscientious Americans with families, living outside the United States, involved in expanding the important international activities of their country. The newspapers constantly quote the recent balance-of-payment deficits, saying that insufficient exports from the U.S. are a major cause. Surely more international-mindedness should be expected from America if these payment trends are to be reversed? The American citizens abroad are constantly in the forefront of 'New Frontiers', and many who have lived outside the U.S. have been adapting an American philosophy to foreign lands. These expatriates remain citizens, although citizens without representative rights. Taxation without representation – shall it continue? Surely international-minded and sensible voices in the United States perceive a need for representation in the U.S. Congress for Americans abroad? The issue has been described and the question of representation asked: how long will the wait be before an answer can be given?

APPENDIX

1 INCREASING U.S. DEPENDENCE ON IMPORTS OF STRATEGIC MATERIALS

	% Imported from All Foreign Sources				*% Imported from Underdeveloped Countries*
	1950	*1970*	*1985*	*2000*	*1971*
Bauxite	64	85	96	98	95
Chromium	n.a.	100	100	100	25
Copper	31	17	34	56	44
Iron	8	30	55	67	32
Lead	39	31	61	67	32
Manganese	88	95	100	100	57
Nickel	94	90	88	89	71
Potassium	13	42	47	61	n.a.
Sulfur	2	15	28	52	31
Tin	77	98	100	100	94
Tungsten	37	50	87	97	37
Vanadium	24	21	32	58	40
Zinc	38	59	73	84	21

2 INCREASING DEPENDENCY ON IMPORTED ENERGY SOURCES U.S.A./OTHER ADVANCED INDUSTRIAL NATIONS

(as a percentage of total domestic consumption)

	1960	1965	1970	1971
TOTAL ENERGY				
U.S.A.	6.2	10.6	8.4	10.3
West Germany	7.9	44.5	58.9	60.6
Japan	46.6	74.9	94.5	98.5
OIL				
U.S.A.	16.3	21.5	21.5	24.0
West Germany	83.8	90.4	94.4	94.7
Japan	100.0	98.2	100.0	100.0
NATURAL GAS				
U.S.A.	1.2	2.8	3.5	3.8
West Germany	0.0	29.3	22.7	29.3
Japan	0.0	0.0	32.3	34.5
COAL AND OTHER SOLID FUELS				
U.S.A.	0.0	0.0	0.0	0.0
West Germany	6.5	7.6	8.8	7.7
Japan	13.3	26.5	56.3	58.7

3

SUMMARY OF FOREIGN EARNED INCOME ACT OF 1978

I. TAX TREATMENT OF AMERICANS WORKING ABROAD

Sec. 4. [1] Delay of Effective Date of 1976 Act

The Act delays the effective date of the changes made by the 1976 Act to the taxation of individuals working abroad so that the law in effect prior to the 1976 Act applies to taxable years beginning prior to January 1, 1978. The section also extends through 1977, but only for those individuals who are entitled to the exclusion, the pre-1976 Act rule that they may not claim both the foreign tax credit and the zero bracket amount (i.e., the standard deduction) in 1977.

Sec. 202. Individuals Residing in Camps

The Act provides an election for employees in camps in hardship areas (places where U.S. Government employees receive a hardship post differential of 15 per cent or more) to claim an exclusion (under sec. 119) for the value of their lodging and an annual exclusion (under sec. 911) of $20,000 in lieu of the excess foreign living expense deductions. A camp for this purpose refers to substandard housing provided in enclaves in remote areas close to the job site where alternative housing is not available on the open market. Employees who elect the benefits of this provision are ineligible for the deductions for excess foreign living costs provided by the Act.

No foreign tax credit is allowed for foreign taxes allocable to the exclusion. As under prior law, deductions are not allowed for amounts allocable to the exclusion, but the deduction for moving expenses allocable to the exclusion will no longer be disallowed.

Sec. 203. Deduction for Excess Foreign Living Costs

The Act provides for a new deduction for excess foreign living costs. Those persons eligible for the deduction are individuals who are *bona fide* residents of a foreign country for an entire taxable year or who are present (including resident aliens) in a foreign country 17 out of 18 months. The excess foreign living cost deduction is a deduction from gross income in determining adjusted gross income, and, accordingly, a taxpayer may claim the deduction without being required to itemize deductions.

The specific terms of the deductions are as follows:

a. Excess cost of living

This element of the deduction consists of an amount determined under IRS tables showing the ecess cost of living in various foreign places for families of various sizes. It is based on the excess of costs in the foreign place over costs in the highest cost metropolitan area in the continental United States (excluding Alaska) and is determined with reference to the spendable income of a person paid the salary of a GS–14, step 1 (currently $32,442), regardless of the taxpayer's actual income.

b. Excess housing costs

This element of the deduction is an amount equal to the excess of the individual's housing expenses over the individual's base housing amount. The individual's base housing amount is one-sixth of his net earned income—that is, one-sixth of the excess of his earned income (minus certain allocable business deductions) over his deductible excess foreign living costs.

Since net earned income is itself a function of the amount allowed as a deduction for excess housing costs, in order to avoid circularity in the computation of the deduction, the base housing amount is computed by taking one-fifth of the excess of the taxpayer's earned income (minus certain allocable business deductions) over the sum of (1) his deductible excess foreign living costs other than the housing element and (2) the *full* cost of the taxpayer's housing. This amount is the mathematical equivalent of one-sixth of net earned income.

The computation of the housing deduction may be illustrated by the following example of an individual with earned income for the year of $45,000 whose deductible education, home leave, and cost of living expenses are $10,000 and whose total housing costs are $15,000. The taxpayer's base housing amount will be $4,000—one-fifth of the $20,000 excess of the taxpayer's $45,000 earned income over (i) his $10,000 of deductible foreign living costs other than the housing element and (ii) the $15,000 spent on housing. Thus, the excess housing cost element of the deduction would be $11,000 (the excess of the $15,000 housing costs over the $4,[illegible] base housing amount), leaving the taxpayer with net ea[illegible]ome of $24,000 ($45,000 less deductible excess living [illegible] of $21,000). The taxable $4,000 base housing amount is one-sixth of net earned income.

A deduction is allowed for the full cost of the taxpayer's own housing rather than just the excess over his base amount if (1) the individual maintains a separate household for his spouse and dependents because of living conditions which are dangerous, unhealthful, or otherwise adverse, (2) the taxpayer's tax home (generally, his principal place of work) is in a hardship area, and (3) the taxpayer's family does not live in the United States. In addition, the taxpayer receives a deduction for the excess costs of maintaining the qualified second household.

c. Educational costs

This element of the deduction consists of the reasonable schooling expenses for the education of the taxpayer's dependents at the elementary and secondary leve. Generally, the cost of tuition, fees, books, and local transportation and of other expenses required by the school are deductible.

Reasonable schooling expenses are determined with reference to the least expensive adequate U.S.-type school, if any, available within a reasonable commuting distance of the individual's tax home. (The dependent may attend school elsewhere, including the United States, but the deduction is limited to that amount.) If an adequate United States-type school is not available within a reasonable commuting distance, deductible schooling expenses include room and board and transportation costs.

d. Home leave transportation

This element of the deduction consists of the reasonable costs of one round trip annually for the taxpayer, his spouse, and each dependent from the location of his tax home outside the United States to the location of the taxpayer's last principal residence in the U.S. or, if there is none, to the nearest port of entry in the continental U.S. (other than Alaska). The deduction is generally limited to coach fare when available.

---

[1] The other sections of title I, except for sections 4 and 5, were made non-effective by section 210 of the Act as of the day after the date of enactment of this Act. These other provisions were dealt with in other legislation: (1) prohibition of commuting expense regulations (sec. 2); (2) prohibition on fringe benefits regulations (sec. 3); (3) application of Code section 117 to certain education programs for members of the Uniformed Services (sec. 6); (4) extensions of 5-year amortization for low-income rental housing (sec. 7); and (5) postponement of 1976 Act rules for certain net operating loss carryovers (sec. 8).

4

U.S. MULTINATIONAL CORPORATIONS
FOREIGN REVENUE, PROFITS AND ASSETS IN RELATION TO TOTAL COMPANY

(amounts in billions of dollars)

Company	*Foreign Revenue*	*Foreign as % of Total Revenue*	*Foreign Operating Profit*	*Foreign as % of Total*	*Foreign Assets*	*Foreign as % of Total*
1. EXXON	$ 44.3	73.5	$ 1.9	56.7	$ 22.6	54.5
2. MOBIL	$ 20.5	59.0	$ 0.6	56.7	$ 11.8	52.3
3. FORD	$ 15.0	35.0	$ 0.8	49.1	$ 10.7	48.6
4. GENERAL MOTORS	$ 14.2	22.4	$ 0.5	12.9	$ 7.2	23.7
5. I.B.M.	$ 11.0	52.4	$ 1.6	50.9	$ 11.0	53.1
6. I.T.T.	$ 10.0	51.7	$ 0.8	54.7	$ 10.4	44.5
7. CITICORP	$ 5.2	68.3	$ 0.6	78.0	$ 50.9	64.5
8. ENGELHARD MINERALS AND CHEMICALS	$ 5.1	50.2	$ 0.1	43.2	$ 1.3	43.9
9. COLGATE-PALMOLIVE	$ 2.4	56.6	$ 0.2	62.4	$ 1.2	50.5
10. COCA-COLA	$ 2.0	45.7	$ 0.5	62.9	$ 1.1	42.3

Source: FORBES, 25 June 1979

5

EXAMPLE OF BREAKDOWNS OF $30,000 PER YEAR SALARY UNDER FOREIGN EARNED INCOME ACT, 1978

(All amounts in US$)		*(1) Cost of living (based on country) Schedule 'H'*	*(2) Education*	*(3) Home Leave*	*(4) Housing*	*(5) Hardship*	*Total Deductions*
Salary	30,000						
Education	4,200		4,200				4,200
Housing (20% of BS)	9,000				3,000		3,000
Home Leave	2,000			2,000			2,000
Cost of Living	4,600	4,600					4,600
Hardship						N/A*	
Total Income	49,800	4,600	4,200	2,000	3,000	N/A*	13,800

*Not applicable

Total Income	49,800
Less:	
Total deduction	13,800
	36,000
U.S. Income Tax	(7,632)
Foreign Tax Credit	6,225
	34,593
Net Tax paid over and above tax already paid in France:	1,407

best copy available

REVISED EDITION OF
TAXATION AND THE SIZE OF THE AMERICAN LABOR FORCE OVERSEAS; A DEMOGRAPHIC ANALYSIS OF CHANGES, CAUSES, CONSEQUENCES, AND PROSPECTS

Jennifer D. Milre, M.A. (USA)
Demographic and Sociological Reports
35 Lennox Gardens, London, S.W. 1
England

REVISED EDITION OF
TAXATION AND THE SIZE OF THE AMERICAN LABOR FORCE OVERSEAS: A DEMOGRAPHIC ANALYSIS OF CHANGES, CAUSES, CONSEQUENCES, AND PROSPECTS

Jennifer D. Milre, M.A. (USA)
Demographic and Sociological Reports
35 Lennox Gardens, London, S.W. 1
England

HIGHLIGHTS

Part I: US and UK Overseas Workers 1973 to 1979
On average 24% fewer Americans work in Britain after 1975
Shortfall amounts to 3,500 man years of work 1975-79
12-17% more repatriation after 4 years of work
The decline coincides with tax proposals year by year
Most major industries are affected
Entertainment industry and banking increased
1979 as bad as 1976-78; tax reforms of 1978 had little effect
British transfers to US increased 29%
British business trips to US increased 34%; US to UK 15%
US-UK balance of trade now less beneficial to US

Part II: The Worldwide Data
At a minimum 19% fewer Americans working overseas
Probability shortfall will worsen
Foreign transfers to US increased 33%
Business trips by foreigners to US up 35%
Perhaps 7% fewer Americans being trained as business travellers

Part III: A Matter-of-Fact Sketch of Americans Abroad
Probably 250,000 working abroad at any one time
Probably 2 to 4 million on shorter business trips abroad
Business travellers come from all US States -- not just a select few
Overseas workers are roughly 20% independents, 30% employees of moderate sized firms, and 50% of large scale firms
Salary level is close to what they earn in US
25% earned less than US median wage
Fringe benefit programs to cover overseas expenses for only 50%
Probably most pay tax in both US and foreign nations
Typical stay is 2-4 years
Roughly 25% to 40% so discontent they return home prematurely
Typically do not live in glamorous place or travel much outside their nation of residence.

Part IV: Perspectives on The Equity and Relevance of Tax Reform
Morale problems are serious; can raise costs because of the high attrition rate
Equity
Inequal to foreign competitors and to residents of the US
Lack of Federal services affects business and personal life
22% of extra expenses nondeductible in a European example
Itemized deductions favor some more than others
Itemized deductions cannot work on a worldwide scale
Relevance
US workforce is one of US's natural advantages in international trade
US needs larger labor pool of resident export experts who have lived abroad
US firms relatively disadvantaged in finding needed US personnel abroad
Policy of sending fewer Americans abroad has been tried- does not seem to increase export.
Potential exporters and overseas workers quite numerous
"Uni-national" firms confront special export problems now

HIGHLIGHTS (continued)

Part V. Proposed Tax Reforms

Total exclusion would be efficacious, but not an unmixed blessing

Substantial exclusion plus housing deduction will have complex and beneficial effects on size and nature of overseas workforce

Identical taxation at home and abroad would cause an exodus

Other alternatives are possible:

1. Total exclusion until international convention makes all nation's overseas workers taxable at home.

2. Unified comprehensive cost of living deduction set for each nation each year by number of dependents could accompany the substantial exclusion.

3. Annual exclusion set for each nation each year by number of dependents a possibility later on.

4. System of analogous tax for Americans abroad and at home is possible if tax structure undergoes profound change

Choice between total exclusion or substantial "exclusion-plus" depends upon which export effects are desired and on other practical considerations within the power of Congress

TABLE OF CONTENTS

Part I. The British Data 1
Definition of Terms 1
The Sources 2
Fewer Americans Are Working in Britain 3
Calendar of Changes in Tax Proposals and Employment 4
Is Tax a Factor in the Decline 6
The Dramatic Change of 1975 6
The Overall Decline 1975-78 9
Which Industries Were Worst Affected? 12
Which Industries Increased Overseas Employment? 12
The Entertainment Industry 12
Totals of Permits Excluding Entertainers 16
1979: As Bad as Ever 16
1979 Versus 1977 Shows a Continuing Drop 16
The American Economic Effort in Britain 19
Is American Trade Expanding in Britain? 19
The Nonworking American Population as a Contrast 21
Britains Transferred to the US 22
The US-UK Economic Balance 26
The UK versus US Tax Situation 26

Part II. The Worldwide Data 27
US Sources and Terms 27
The Worldwide Shortfall of Americans Working Abroad 28
Evidence of the Influence of Tax 32
The Contrast of Transfers to the US 34
International Business Trips 37
Summary 37

Part III. A Matter-of-Fact Sketch of Americans Abroad 40
How Many Are They? 40
How Many Have Short Term Experience Overseas? 41
The High Income of Overseas Earners 41
Fringe Benefits to Cover Overseas Expenses 43
What Size of Firms Do They Work For? 43
The Tax Dilemma 44
Do American Earners Overseas Pay US and Foreign Tax? 44
Is it Easy to Evade US Tax? 44
The Life Style in General 45
The Life Style in Britain 45
Summary: A Composite Sketch 48

Part IV. Perspectives on the Equity and Relevance of Tax Reform 49
The Question of Equity 49
Unequal to Their Foreign Competitors 49
Unequal to US Residents 50
Equity for American Resident Taxpayers 50
Equity and the Extra Expenses Abroad 52
Equity and the Problem of Itemized Deductions 56

TABLE OF CONTENTS (continued)

Perspectives: The Relevance of Tax Reform 56
Do Americans Abroad Increase US Export? 56
Reasons American Personnel Should Be Encouraged to Work Overseas 57
Foreign Firms in US at Greater Advantage than US Firms Abroad 58
Number of Individuals and Firms Affected by Export Incentive 59
Uni-nationals, Bi- and Tri-nationals, Internationals and Multinationals 59
The Safeguard Against Unnecessary Postings Abroad 60

Part V: The Reform of Overseas Income Tax 61
The Extent of Tax Modification Required 61
Should All Workers Overseas Benefit? 61
Proposed Reforms Analyzed by Population Effects 62
How Many Would Benefit Directly, for How Long? 62
The Proposed Total Exclusion 62
The Substantial Exclusion with Housing Deduction 64
The Housing Deduction 65
Taxation Overseas Identical to Taxation in the US 67
Alternative Versions of the Proposals 68
A Total Exclusion Until Other Nations Tax Their Citizens Who Work Abroad 68
The Substantial Exclusion Plus a Unified Deduction For Each Nation Each Year by Number of Dependents 69
Annual Substantial Exclusions Set for Each Nation Each Year by Number of Dependents 70
Analogous Taxation Overseas and in the US 70
Which Measure Should Be Adopted Now? 71

Bibliography 73

TABLE OF TABLES

Part I. The British Data

1. Average Shortfall 1975-78 5
2. Applications versus Arrivals of Permit Holders 1973-78 7
3. The Dramatic Change of 1975 8
4. Workloss 1975-78 10
5. Workers Staying on After 4+ Years of Work 1973-78 11
6. Permissions to Take Long Term Work 1973-78 13
7. Short Term Permits 1973-78 13
8. Short Term Permissions 1973-78 14
9. Business Trips 1973-78 14
10. Declines by Industry 1978 versus 1974 14
11. Rises by Industry 1978 versus 1974 15
12. Total Work Permits with and without Entertainers 15
13. 1979 versus 1973-74 17
14. Declines by Industry 1979 versus 1974 17
15. Rise by Industry 1979 versus 1974 18
16. 1979 versus 1977 18
17. 1979 versus 1977 minus Entertainers 18
18. US-UK Export Import Balance 20
19. Nonworking Americans Entering and in the UK 20
20. British Transfers to the US 1973-77 23
21. US and UK Business Trips 1973-77 23
22. UK and US Dependency Ratios 24
22a Estimated Long Term British Transfers to the US 24
22b Estimated Family Size and Number of Dependents 25

Part II. The Worldwide Data

23. Change in Known Motives and in Business Travellers 29
24. Business Passports by Duration of Stay 1973-78 30
25. Long Stay Business Trips 1973-78 31
26. Decline in Short and Long Term Business Travel 33
27. Decline in Nonworking and Working Long Term Passports 33
28. Worldwide Transfers to the US 1973-77 35
29. Estimated Rise in Long Term Transfers to the US 35
30. Transfers to the US from Selected Nations 1973-77 36
31. Business Trips to the US 1973-77 39
32. Extant Passports versus Extant Business Passports 39

Part III. A Matter-of-Fact Sketch of Americans Abroad

33. Estimate of Long Term Workers Overseas 42
34. Estimate of Passports Sometimes Used for Business 42
35. Origin of Business Travellers by Region and State 42
36. Out of Britain Travel by Americans Resident in the UK 47
37. American Residents' Departures from the UK 47
38. US Citizens Becoming British Subjects 47

Part IV. Perspectives on the Equity and Relevance of Tax Reform

39. Some Federal Services Less Accessible Abroad 51
40. Nondeductible Extra Costs 53
41. A Very Crude Budget of Extra Expenses 54
42. Cost of Living in 4 European Nations 1978 55

PART I

THE BRITISH DATA

British Statistics Prove A Sharp Decline in Americans Working in Britain

Britain can provide definitive statistics indicating whether the number of Americans working there is growing or shrinking. Though there is no data on the total number of the working population, there is strict enumeration of all alien arrivals coming to work, and all alien workers staying on after four years. The data can thus be used as a measure of the change in America's working presence. The facts are available because Britain has a very strictly enforced policy of immigration and a system of mandatory work permits for any alien taking any employment there. The data appear semi-annually and annually. The statistics used cover only individuals in private employment; they will not include diplomats or other civilian and military personnel.

Definition of Terms

Work permits must be obtained for a specifically named individual to fill a specific post and must be issued prior to his arrival. Employers seeking permits for aliens must meet strict criteria before permits are issued. Even employers who merely wish to transfer someone from a foreign branch to a British branch of an international firm must comply with the regulations. In all instances the potential employee must be highly skilled or a professional, and the employer must prove that the alien could not be replaced by a UK national.

Work permissions are issued for aliens who are already in the United Kingdom as residents, visitors, or on a business trip. The criteria for issuances are as strict as those for permits.

Long term permits and permissions are issued for a maximum of twelve months, and are renewable, but no data on renewals is published.

Short term permits are issued for stays of more than 3 months and less than 12 months.

Business trips are stays of less than 3 months; they are recorded, but they require no permit.

Removal of the time limit occurs when an employed alien has completed four years of work in compliance with all the regulations. Thereafter the individual is free to take what employment he likes, set up his own business, and come and go as he chooses.

The grand total of permits includes all the long term and short term permits and permissions issued. It is a significant indicator of the size of the American workforce because short term employees sometimes transfer to long term status.

Comparisons will be made between 1973-1974 versus 1975-1979 because in 1973 the permit regulations and published data underwent modification. By lucky accident, US data which is relevant was also reformed and regularized at the same time. Prior to 1973 the criteria for control of aliens working in Britain were not comparable and only grand totals were published. In general, the pre-1973 data indicate a steady flow of Americans and a larger flow than occurs now.

The Sources

The Control of Immigration Statistics is published yearly by the Home Office. It documents the number of aliens who enter the UK by nationality and by other sub-categories. The categories distinguish between those who arrive with long term work permits and those who arrive with permits for shorter periods. The statistics also indicate the number of business travellers, and the number of residents who have completed four years of registered and approved work and are staying on -- a significant group. It gives data on the dependents of permit holders, on the number of arriving students, on people allowed to stay 12 months without taking work, and on the number of aliens' journeys outside the UK. Data is available for 1973 to 1978.

Additional information is available through the Department of Employment, which issues the permits, in its Gazette. This shows the number and types of work permits issued, as distinct from the actual arrivals shown by the Home Office. It breaks down the data by industrial groups and by occupational groups as well. Their tables indicate whether work permits are for the long or the short term. Permissions (for aliens already in the country) are also shown, a piece of information which the Home Office cannot provide. Data is available from 1973 to the first half of 1979.

The United Kingdom Census (1971) provides a notional impression of the entire American population in the UK even though it is out of date. It gives the full number of foreigners by nationalities, not just those who work. It also indicates their region of residence and the year of their arrival. It does not indicate employment or income, nor does it distinguish between people in the private sector and those who are government employees and/or dependents.

FEWER AMERICANS ARE WORKING IN BRITAIN

It is a fact that the number of Americans sent to Britain for long term employment, the number hired there, and the number staying on after four years work all declined sharply in 1975 along with proposed changes in US income tax overseas. The number has remained low thereafter. By 1978 it had barely risen to the pre-1975 range. It dropped again in the first half of 1979.

The average annual diminution is -24% or -706 long term employees per year 1975-1978. (Table 1)

The total minimum effect is the equivalent of -2504 fewer Americans working in Britain for a year -- or -2504 man-years between 1975 and 1978 (Table 4)

Thus at the very time when America's trade problems called for expansion, fewer Americans were being sent abroad to Britain to bring about that change.

The shift occurred dramatically in 1975, the year when Congress proposed to abolish the exclusion on income earned abroad and rejected the idea that allowance should be made for the unusual expenses abroad of private employees (though government employees were to keep their tax-free allowances pending further study). In 1975 alone there was a 32% (490 employees) decline in the number of Americans transferring into Britain for long term work. (Table 3). In 1976 there was a relative rise in new arrivals, but the total number stayed low. Fewer stayed on after 4 years of work and fewer were hired in on the spot. The tax prospects remained the same.

In 1977 new arrivals increased back to the norm, thanks probably to the fact that there had been a delay proposed in the abolition of the exclusion. Nevertheless fewer were being kept on or choosing to stay on after four years work, and fewer were hired while in Britain.

By 1978 new arrivals rose above the norm. It was in February of that year that Ways and Means held sympathetic hearings on the problems of expenses and costs, and in May the Senate Finance Committee indicated comparable concern. Helpful changes seemed to be in the offing.

But in 1979 after changes proved to be less than expected, when the exclusion was clearly to be abolished, and when rumor had it that the issue was permanently closed for good and all, the numbers dropped again.

American businesses shifted their efforts into short sojourns when they pared down on long term postings in 1975. They raised the number of short term residencies by 23% at first and later increased business trips by 17% instead. Such a transfer policy avoids the problems of overseas income tax. (See Calendar overleaf, and Tables 7 and 9).

Unfortunately that policy does not seem to have succeeded in expanding trade.

Calendar of Changes in Tax Proposals and Changes in Overseas Employment Year by Year

- 1973-4 Exclusion in effect and not threatened
  - Steady number of long term workers
    - Permit holders arriving
    - Permissions issued frequently
    - 4-year workers staying on
- 1975 Tax exclusion to be abolished and no allowance for expenses other than education
  - Sharp drop in arrival of permit holders though normal number of permits had been issued
  - Decline in keeping 4-year employees
  - Decline in hiring Americans in the UK
  - Sharp rise in short term postings
  - Drop in business trips
- 1976 Tax situation remains the same
  - Long term workers increase, still below base years
    - Increase in arrivals, still low
    - Decline in keeping 4-year employees
    - Decline in hiring Americans in the UK
    - Decline in arrival of short term personnel
    - Rise in business trips
- 1977 Proposal to postpone abolition of the exclusion
  - Numbers rise somewhat
    - Increase in arrivals, reaches norm
    - Decline in keeping 4-year employees
    - Stasis in hiring Americans in the UK
    - Short term residencies rather low
    - Business trips rise
- 1978 Sympathetic hearings on overseas tax problems in February and May
  - Numbers increase
    - Long term arrivals rise above the norm
    - Keeping 4-year employees nearly reaches norm
    - Hiring of Americans in the UK remains low
    - Rise in short term residents
    - Rise in business trips
- 1979 Exclusion definitely to be abolished and no plans for improved deductions.
  - Decline in numbers again
    - Fewer arrivals
    - Fewer hirings of Americans in the UK
    - No information on 4-year employees
- 1980 Tax issue re-opened in December 1979
  - Effects unknown

Table 1

Average Shortfall of American Workers 1975-78 versus 1973-74

Category	Average 1975-1978	Average 1973-1974
Arrivals with 12 mos permits	1398	1544
12 mos. Permisns.	257	737
Staying on after 4 years work	567	647
Total annual average	2222	2928
Decline		
In Percent	-24%	
In Number	-706	

Is Tax a Factor in the Decline?

The proposed changes had immediate effects on overseas transfers because employees are usually sent abroad for periods of 2-4 years. (Table 24) Even though the phasing out was to be gradual, the change became relevant the minute it was proposed. Employees sent abroad prior to the effective date were likely to become subject to its stipulations before they returned home. Their tax rate became a matter of immediate concern to themselves and/or their firms.

From its inception the proposal to increase taxes abroad would have been widely known. It was first mooted in October 1974 when the Joint Economic Committee's investigation into various tax shelters appeared. By January 1975 Businessweek published a feature on the high cost of sending employees abroad and warned that their taxes might be increased as well. In mid-1975 alerted industries were testifying against the change at hearings held by Ways and Means. Since 1975 news and business magazines have publicized this factor at least three times a year. By January 1979 the Monthly Labor Review warned that remuneration overseas would be affected by tax changes in its feature on overseas cost of living, an item which is consulted by many transferring firms.

The fact that it is long term postings alone which went into a steep slump and stayed down suggests that the tax change has had a major influence. All other aspects of overseas trade efforts slumped less and rose soon again; all of them are unaffected by the income tax change. Short term postings increased; business trips increased, and foreigners (untaxed) posted into the US increased after 1975 (Tables 7, 9, and 28)

Aside from income tax, all these facets of overseas transfer practices are subject to the same difficulties of the economic climate that long term postings are, but they recovered after 1975. Long term postings are subject to the tax change and they continued to slump.

The Dramatic Change of 1975

When the abolition of the exclusion for overseas earned income was first threatened, there occurred an abrupt 29% drop in the new employees and continuing working residents in Britain. A total of 841 fewer working Americans were working in the United Kingdom within the year. (Table 3)

At this point it was not known what allowances -- if any -- would be made for the extra costs of sending workers overseas. Apprehension induced retreat.

This sudden change was not originally intended by the firms employing US citizens in the UK. The number of applications for workpermits were as high in 1975 as they had been before. What seems to have happened is that employers cancelled transfers of employees whom they had intended to send, and/or employees refused to accept the offered posts. (Table 2)

Table 2

Applications versus Arrivals of Long Term Work Permit Holders 1973-78

Year	Permits Issued	Arrivals	Per cent Arriving
1978	1862	1622	87%
1977	1837	1599	87%
1976	1683	1317	78%
1975	1779	1052	59%
1974	1846	1542	84%
1973	2079	1545	74%
Average Permits Issued	**Number**	**% Over 1973-74**	**No. Over 1973-74**
1977-78	1850	-6%	-113
1975-76	1731	-12%	-232
1973-74	1963		
Average Arrivals			
1977-78	1611	4%	67
1975-76	1185	-23%	-359
1973-1974	1544		

Table 3

The Dramatic Changes of 1975

Workers	1975	1974	% Diff.	No. Diff.
Arrivals with 12 mo. permits	1052	1542	-32%	-490
12 mo. Permissions	426	660	-35%	-234
Continuance after 4 yrs.	563	680	-17%	-117
Total	2041	2882	-29%	-841
Business Trips	177,000	186,000	-5%	-9,000
Short Term Workers				
Issuances	2946	2964	-1%	-18
Arrivals	2876	2002	30%	874
% Arriving	98%	68%	31%	--

ERRATA SHEET

The Revised Edition of
Taxation and the Size of the American Labor Force Overseas

1. Page 9, Paragraph 9 (Changes underlined): Worse yet, decrease in long term employees was so extreme that short term workers who were their substitutes failed to exceed their number. An extra 1,964 short termers went to the UK above and beyond the norm of 1973-74, but short term workers cannot possibly be the equivalent of long term employees. The deficit in man years of work is 4,026 ...

2. Page 10, Table 4:
Permit Arrivals 1977-78 should read +932 (not 1652)
Permit Arrivals Total should read 2,200 (not 2920)
Total -- Total should read 1,964 (not 2,684) for No. of Workers
and 982 (not 1342) for No. of Years
Years lost should read -4026 (not -3,666)

3. Page 13, Table 7:
Average Arrivals 1977-78 should read 2,597 (not 2957)
1977-78; % Over 1973-74 should read 18% (not 28%)
1977-78; No. Over 1973-74 should read 466 (not 826)

4. Page 23, Table 21:
Average 1976-77 US to UK should read 4892 (not 4874)

5. Page 24, Table 22:
Average should be for years 1976-77 (not 1975-77)

6. Page 30, Table 24, Part II, The Percentages:
1977 for 1-2 months read 7.6 (not 7.8)
2-6 months read 5.4 (not 5.2)
1976 for 1-2 months read 8.2 (not 8.0)
2-6 months read 6.0 (not 5.8)
1975 for 2-6 months read 6.3 (not 6.2)

The table for 1975 as a whole shows that 32% fewer new long term employees arrived, 35% fewer workers on the spot were hired into long term jobs, and 17% fewer people eligible to stay on after 4 years of work did stay on. At one fell swoop the American community lost long term residents whose local expertize had been learned over the years and slacked off in recruiting ultimate replacements for them. (Table 3)

Concommitantly there was an abrupt increase in the number of short term employees coming for short bouts of work which would be unaffected by the exclusion or its change. In 1975 an astounding 98% of those with short term permits arrived, whereas in other years the proportion never rose above 82%. (Tables 3 and 7)

It looks as if a significant proportion of American firms altered their policy on overseas transfers by cutting down on sending employees overseas for a year and more. Instead they tried to increase trade by sending more individuals abroad for a mere few months with the hope that those individuals could be as effective as long term residents.

Within the year they shifted away from that policy; evidently it did not attain the effects desired.

The Overall Decline 1975-1978

After 1975 firms gradually began to send a few more long term employees to Britain each year, presumably because short term substitutes were not filling the bill, as evidenced by the fact that short term trips were diminished again in later years. (Table 6).

The backlog of missing long term employees from 1975 to 1978 amounts to 2,504. (Table 4).

And the pattern persists. In 1979 there were 38% fewer (-1018 employees) permit and permission issuances than there were in 1973-74. (Table 13)

The full value of the employees who failed to take up work is greater than 2,504 (or 3,522 adjusting for 1979) because most would have stayed on longer than one year.

Worse yet, the decrease in long term employees was so extreme that short term workers who were their substitutes barely exceed their number. An extra 2,684 short termers were sent to the UK above and beyond the short term norm of 1973-74, but short term workers cannot possibly be the equivalent of long term employees. The deficit in man years of work is 3,666, assuming 2 years of work per long term employee and 6 months per short term worker. (Table 4) The real loss is more severe, for newcomers are often inept in foreign situations and thus less effective than long term employees are.

Nor are firms retaining their longest term employees -- the most valuable of all since they are fully familiar with the ins and outs of the local situation. On average 12% (80 people) fewer of four year employees are staying on. (Table 5) They amount to 320 fewer knowledgeable Americans in Britain 1975-78. Since this problem affects people staying for their 2nd, 3rd and nth year as well, the extra

Table 4

The Long Term Employees Who Did Not Start Work in Britain Versus the Short Term Employees Who Came Instead 1975-78

Long Term Employees Who Did Not Work in Britain			
Category	**1977-78**	**1975-76**	**Total**
Permit Arrivals	**+134**	**-718**	**-584**
Permissions	**-1124**	**-796**	**-1920**
Deficit			**-2,504**
Short Term Employees in Excess of 1973-74 Norm			
Permit Arrivals	**1652**	**1268**	**2,920**
Permissions	**-130**	**-106**	**-236**
Total			**2,684**
Years of Workloss	**No. of Workers**	**No. of Years**	
LT, 2 yrs each	**-2,504**	**-5008**	
ST, 6 mos. each	**2,684**	**1,342**	
Years lost		**-3,666**	

Table 5
Staying on After Four Years Work Experience 1973-1978
(Removal of the Time Limit)

Year	Number
1978	621
1977	523
1976	560
1975	563
1974	680
1973	614

Averages	Number	% Over 1973-74	No. Over 1973-74
1977-78	572	-12%	-75
1975-76	562	-13%	-85
1973-74	647		

repatriated employees may well amount to more than 1,000. Considerable expertize, and investment in expertize, is thus being lost.

The drop in long term permissions means that fewer firms are hiring American experts already in Britain when the need or the opportunity arises. The difference is a decline of 76% or 562 people. Either firms are hiring UK nationals instead or leaving the posts unfilled. It is not for want of Americans in Britain who might be hired; ever more Americans are coming to Britain on business trips each year. (Tables 6 and 9)

Short business trips are in fact the one instance of consistently expanding American efforts in Britain. They increased 17% over 1973-74. (Table 9)

Which Industries Were Worst Affected?

Industry by industry data can provide an approximate idea of where the worst effects have occurred. The statistics must be read as indicative rather than definitive since the analyses are based on the grand total of permits (including short term as well as long term permits and permissions); that is the best the data will allow.

The fields which were worst hit, comparing 1978 with 1974 were: (Table 10)

Agriculture-oil-mining, -28% or -129 people in 1978
Coal and chemicals, -39% or -64 people in 1978
Construction and utilities, -84% or -213 people in 1978
Professional and scientific, -27% or -220 people in 1978

Data on occupation first appeared in 1977, so comparison can only be made for this between 1977 and 1978. Those years show a decline in: (Table 10)

High level managers, -32% or -86 people
Engineers, -19% or -98 people.

Thus it is some of the major industries and areas which were once fields of special American expertize that are now manifesting a decline.

Which Industries Increased Overseas Employment?

A few industries increased the number of their American employees arriving in 1978 versus 1974. (Table 11)

Entertainment rose by 30% or 1073 people
Banking-Insurance-Finance rose by 14% or 62 people.
Metal and Vehicles rose by 15% or 77 people; however 1979 data shows a 6% or 27 person drop (Table 14)

The Entertainment Industry

The entertainment industry has always been a large portion of the grand total of Americans working in Britain, which does, it should be remembered, include short term as well as long term work. In 1973-74 entertainers accounted for 43% of the grand total. By 1977-78 they accounted for 58%. (Table 12)

Table 6

Permissions to Take Long Term Work: Employees Accepting a Long Term Post While in Britain

Year	Number		
1978	176		
1977	174		
1976	252		
1975	426		
1974	660		
1973	813		
Averages	Number	% Over 1973-74	No. Over 1973-74
1977-78	175	-76%	-562
1975-76	339	-54%	-398
1973-74	737		

Table 7

Short Term Permits 1973-78

Year	Permits	Arrivals	% Arriving
1978	3738	2964	79%
1977	2847	2229	78%
1976	2859	2653	93%
1975	2946	2876	98%
1974	2964	2002	68%
1973	2759	2260	82%
Average Issuances	Number	% Over 1973-74	No. Over 1973-74
1977-78	3293	13%	431
1975-76	2903	1%	41
1973-74	2862		
Average Arrivals	Number	% Over 1973-74	No. Over 1973-74
1977-78	2957	28%	826
1975- 76	2765	23%	634
1973-74	2131		

Table 8

Short Term Permissions Issued 1973-1978

Year	Number	Averages
1978	92	
1977	53	73
1976	79	
1975	90	85
1974	150	
1973	125	138

Table 9

Business Trips to Britain 1973-78

Year	Number	Averages	% Over 1973-74
1978	229,000	221,000	17%
1977	212,000		
1976	201,000	189,000	3%
1975	177,000		
1974	186,000		
1973	180,000	183,000	

Table 10

Declines in Grand Totals by Industry 1978 versus 1974

Industry	1978	1974	% Diff.	No. Diff.
Ag-oil & mines	334	463	-28%	-129
Coal & Chem	100	164	-39%	-64
Constructn & Utilities	41	254	-84%	-213
Professional & Scientific	596	816	-27%	-220

By Occupation: 1978 versus 1977 (Only years available)

Occupation	1978	1977	% Diff.	No. Diff.
Top Managers	186	272	-32%	-86
Engineers	413	511	-19%	-98

Table 11

Rises in Grand Totals by Industry 1978 versus 1974

Industry	1978	1974	% Diff.	No. Diff.
Metal & Vehicles	512	435	15%	77
Banking & Insurance & Finance	428	366	14%	62
Entertainment	3556	2483	30%	1,073

Table 12

Grand Total Issuances With and Without Entertainers 1973-78

Year	Total	Entertainers	Subtotal
1979	5288	3342	1946
1978	5868	3556	2312
1977	4911	2633	2278
1976	4873	2751	2122
1975	5241	2647	2594
1974	5620	2483	3137
1973	5776	2442	3334

Average Without Entertainers

Year	Subtotal	% 1973-74	No. 1973-74
1979	1946	-40%	-1290
1977-78	2295	-29%	-941
1975-76	2358	-27%	-878
1973-74	3236		
1975-79 Change Average	2250	-30%	-986

The problem is not that entertainers are on the increase; films and TV series are an export item for the US. The problem is that other branches of endeavor are on the decline.

The Grand Total of Permits -- Excluding Entertainers

There has been a decline of 30% or 986 people per year in American employees, short term as well as long term, if the entertainment industry's employees are removed from the total. (Table 12)

American industry in general then is clearly making less effort 1975-1979 than in 1973-74 to expand its overseas trade and presence.

1979: As Bad As Ever

The data on work permit issuances has appeared for January to June 1979. An estimate for the full year has been made by simple doubling; it is probably sound, since semi-annual statistics from 1966 to 1978 indicate approximately equal issuances in each half of the year.

The position in 1979 looks to be as bad as ever it has been in comparison to 1973-74 -- 1975 excepted. There is a 38% shortage in long term employees (-1018 people) and short term workers do not make up the difference with their 606 person increase. The grand total excluding entertainers shows a drop of 40% (1290 people) in Americans taking jobs in the UK. (Tables 12 and 13)

Analysis by industry shows declines in most major fields when comparing 1979 to 1974: (Table 14)

Agriculture-oil-mining, -39% or -181 people
Coal and chemicals, -45% or -74 people
Construction and utilities, -87% or -222 people
Professional and scientific, -47% or 384 people
Metal and vehicles, -6% or -27 people

On the other hand, rises persisted in 1979 for banking and entertainment: (Table 15)

Banking-insurance-finance 18% or 84 people
Entertainment 26% or 859 people

1979 Versus 1977 Shows A Continuing Drop: 1978 Tax Reform Seems an Inadequate Incentive

The 1979 decline occurred after the 1978 hearings and subsequent modifications of tax. The changes seem not to have had the desired effect even on transferees into a developed nation like Britain.

The transfers in 1979 were lower than those in 1977 as well as lower than the 1973-74 base. This fact reinforces the overall indication that the 1978 modifications were not adequate or suitable means for increasing postings into developed areas. Long term postings were 16% (329 people) fewer in 1979 than in 1977. (Table 16) Total postings (long and short term together) had decreased by 15% (332 people) excluding entertainers. (Table 17)

The American presence in Britain is still declining in most industries , and long term resident employees are becoming rarer and scarcer year by year.

Table 13

The Position in 1979 versus 1973-74

Category	1979	1973-74	% Over 1973-74	No. Over 1973-74
LT Permits	1562	1963	-20%	-401
Permissions	120	737	-84%	-617
LT Total	1682	2700	-38%	-1018
Short Term				
Permits	3572	2862	20%	710
Permisns	34	138	-75%	-104
ST Total	3606	3000	17%	606
Workloss for 1979				
	No. of Workers		No. of Years	
LT, 2 yrs each	-1018		-2036	
ST, 6 mos. each	606		303	
Years lost			-1,733	

Table 14

Declines by Industry in Grand Totals 1979 versus 1974

Industry	1979	1974	% Over 1974	No. Over 1974
Ag-oil & mines	282	463	-39%	-181
Coal & Chem.	90	164	-45%	-74
Constrctn & Utilities	32	254	-87%	-222
Professional & Scientific	432	816	-47%	-384
Metal & Vehicles	408	435	-6%	-27
Totals	1244	2132	-42%	-888

Table 15

Rises by Industry in Grand Totals 1979 versus 1974

Industry	1979	1974	% Over 1974	No. Over 1974
Banking & Finance	450	366	19%	84
Entertainment	3342	2483	26%	859

Table 16

1979 versus 1977: Before and After the 1978 Tax Reform

Category	1979	1977
12+ Permits	1562	1837
12+ Permisns	120	174
Totals	1682	2011
Differences	-16%	
	-329	

Table 17

1979 versus 1977: Grand Totals Minus Entertainers

Category	1979	1977
Grand Total	5288	4911
Entertainers	3342	2633
Subtotal	1946	2278
Differences	-15%	
	-332	

The American Economic Effort in Britain

The 1500 to 2000 Americans who come to Britain annually with permission to work for 12 months seems a rather small number when set against the US business interests and potential in the UK.

At least 6500 Anglo-American business ties and affiliations exist at present, as estimated from the 13,000+ listings in the Trade Directory of the American Chamber of Commerce. Some are full-fledged affiliations with resident branches in both nations; others are mere visiting relationships based on short business trips and capable of considerable expansion.

Multinationals are only one part of the American effort in Britain. Twenty per cent of Britain's largest 1,000 companies are indeed American owned according to the annual study The Times' 1,000.

That leaves several thousand moderate sized American concerns trying to work in Britain with weaker economic bases and less international expertize than the multinationals have.

Financial problems are a difficulty overseas even for the American top 200 in the UK. Seven per cent of them (or 14 major firms) lost money in 1977-78 -- excluding Chrysler -- in comparison to only 2.6% of the other top 1,000 firms in Britain.

The thousands of moderate sized and relatively small firms may well run similar economic risks and face worse problems and find it even more difficult to send American employees abroad in order to expand trade and obtain greater expertize in foreign conditions.

Is American Trade Expanding in Britain?

The brief answer is "No". The import export balance shows a drop in America's former advantage in trade with the UK. Work permit data indicates that there is not much increase in new American ventures there and that other aspects of effort are also on a relative decline.

The preponderance of US exports to the UK over British exports to the US has declined over the years. (Table 18)

Multinationals and smaller firms alike are retreating in competitive effort. The large firms have lowered the amount they are investing abroad according to the US Statistical Abstract. And British business trips to the US have increased much more than US business trips to the UK. (Table 21)

The low number of work permits indicates few new concerns or branches being founded, because work permits are required for anyone who intends to start a new business or establish a first branch -- whether in manufacturing or in sales. Thus the several thousand moderate and smaller firms with British ties are not currently expanding and developing their potential in the UK.

The extra cost of tax is one relevant factor in this stasis. Establishing new branches or resident sales

Table 18

US Merchandise Exports to UK Contrasted to UK Merchandise Exports to US
(In Millions of Dollars)

Year	US to UK	UK to US	% US Ahead	$s US Ahead
1977	5,380	5,068	6%	312
1976	4,801	4,254	11%	547
1975	4,527	3,773	17%	754
1974	4,574	4,023	12%	551
1973	3,564	3,657	-3%	-93
1970	2,536	2,194	13%	-342
1965	1,615	1,405	13%	210
1960	1,487	993	33%	494

Table 19

Americans in the UK Who are Not at Work in the Private Sector

Category	1978	1974	% Change
Entrants			
Tourists (millions)	1.5	.992	34%
Students	15,033	12,334	18%
Diplomats & Dependents	4,528	8,571	-47%
Nonworkers Staying 12+ mos.	11,294	16,677	-32%
Residents			
(Registred for 0-4 yrs)	30,722	31,706	-3%

forces abroad are expensive moves. Companies calculate costs and risks and profits carefully in advance when they make such a large investment. Differences of a few per centage points can be significant, especially if the companies are of moderate size or do not have a lot of capital available or do not have a lot of previous overseas experience to rely upon.

The Nonworking American Population in Britain as a Contrast

The number of working Americans has diminished more severely than most other categories of Americans in the private sector. Comparing 1978 with 1974 tourism has actually increased by 34% and student residents by 18%. American non-governmental aliens registered with the Home Office as living in Britain for less than 5 years (workers and nonworkers alike) declined by only 3%. Government sponsored travel seems to have diminished more than private employment; diplomats and their dependents declined by 48%; nevertheless they still outnumber individuals in the private sector (and their dependents) coming to work for a year and more. Nonworking US citizens planning to stay for 12 months and more, a large portion of whom but an unknown portion of whom are NATO dependents, went down by 32%. (Revert to Table 19)

In short, the new economic situation of the 1970s seems to be having a more discouraging effect on working Americans coming to Britain than it has had on the rest of the private sector. Once again the evidence suggests taxation is a significant cause; the workers are subject to income tax changes, while the nonworkers are not. The effect has not proved beneficial to the American balance of trade.

The Contrast of British Employees Transferred to the US

Intracompany transfers of British employees to the US have risen at the very time when the number of Americans going to work in the UK declined -- whether they went as intracompany transfers or not.

The information on British intracompany transfers comes from the US Immigration Service's Annual Report. Intracompany transfers seemed the most relevant category of arrivals; the alternatives of genuine immigrants or temporary workers have been ignored since they are not comparable to US workers going to the UK (but it should be noted that including them would only exaggerate the UK versus US contrast). ITCs or intracompany transfers include both long and short term workers, so they will be compared to all US long and short term permit holders in the UK. Estimates of long term stays can and will be made. Data for 1977 is the latest data available in libraries in the UK.

The British Transferred to the US

British transfers, like US transfers, diminished in 1975. There were fewer Britons transferred to the US and fewer business trips; even tourism fell off.

But British recovery and increase followed within the year. By 1976 Britons coming to work in the US rose. By 1977 intracompany transfers of British workers had risen 29% above 1973-74 while American transfers continued to decrease. British business trips increased even more than American ones did. (Tables 20 and 21)

The change produced a difference of 1899 people a year in Britain's favor 1975 and after. On average there have been an additional 1093 Britons transferred to the US to work (both short and long term) and an average of 806 fewer comparable Americans going to the UK. If the trend continued 1976-1979 the total difference is 7596 man years.

As of 1977 Britons arriving as transferees to the US equal the total number of Americans going to Britain to work -- whether as intracompany transfers or not. (Tables 20 and 22)

It looks as if 28+% more British transferees work for long periods than American transferees do. The changing ratio of dependents provides a measure of the proportion staying a long time since family size over time in the two nations is comparable. Table 22 shows a 14% rise in the number of British dependents and hence a likely 14% rise in long term transferees; it also shows 28+% more dependents and thus 28+% more long term transferees among Britons than Americans for 1976-1977.

An estimate of long term British transfers suggests they have increased by 40% or 790 people per year. (Table 22a) The estimate has been arrived at by assuming 1.5 dependents, which oddly enough looks to be the appropriate number. Not all dependents accompany overseas workers; some remain back home in "public" school, some with a separated spouse (more common for Americans), and some are adult enough to live on their own. Table 22b shows how such a low number of dependents can easily occur simply because financial dependents do not necessarily reside with overseas workers and thus do not show up in the immigration data, though they may make a visit and be counted as visitors.

How much of the increased British presence in the US is paid for by British firms and how much is financed by American firms is not known. THe likelihood is that both factors are significant since the American business community generally admits it is hiring more foreign employees and since it is known that Britain is investing more and more in the US.

Whoever foots the bill, the consequences are still the same and to the disadvantage of the US. More British are gaining the cosmopolitan expertize of working abroad and fewer Americans are.

Table 20

Britons Transferred to the US as Intracompany Transfers Versus All US Permit Issuances For the UK (Long and short term in Both National Groups)

Year	UK ICTs To US	% Over Prior Yr.	US To UK	% Over Prior Yr.
1977	4349	24%	4911	1%
1976	3300	18%	4873	-7%
1975	2693	-16%	5241	-7%
1974	3204	29%	5620	-3%
1973	2259		5776	
Averages				
1976-77	3825		4874	
1973-74	2732		5698	
Average Annual Differences 1976-77 versus 1973-74				
	1093	29%	-806	-14%
Ratio of American Permit Holders to British Transferees				
1977	1.1			
1976	1.5			
1975	2.0			
1974	1.8			
1973	2.6			

Table 21

Business Trips 1973-1977. US to UK versus UK to US (Numbers in 1,000s)

Year	UK To US	% Over Prior Yr	US To UK	% Over Prior Yr.
1977	102	17%	212	5%
1976	85	15%	201	12%
1975	72	-8%	177	-5%
1974	78	14%	186	3%
1973	67		180	
Change 1977 versus 1973				
		34%	15%	
Ratio of American to British Business Trips				
1977	2.1			
1976	2.4			
1975	2.5			
1974	2.4			
1973	2.7			

Table 22

Dependency Ratio for UK Intracompany Transferees and for US Permit Holders Arriving: Short and Long Term for Both Nationalities
(An Indication of Proportion Staying Long Enough to Warrant Family Transfers)

Year	ICTs	Deps.	Ratio	US	Deps.	Ratio	% UK Higher
1977	4349	3527	.81	3828	2177	.57	30%
1976	3300	2335	.71	3970	2024	.51	28%
1975	2693	2059	.76	3928	1807	.46	40%
1974	3204	1882	.59	3544	2165	.61	-3%
1973	2259	1611	.71	3805	2390	.63	11%
Averages							
1975-77			.76			.54	
1973-74			.65			.62	
Change 1976-77 versus 1973-74							
		UK	14%			US	-13%

Table 22A

Estimated British Intracompany Transfers to US
(At 1.5 Dependents per Long Term Transferee)

Year	Dependents	Estimated LT Transfers	% Over Prior Year
1977	3527	2351	34%
1976	2335	1557	12%
1975	2059	1373	9%
1974	1882	1254	14%
1973	1611	1074	
Averages			
1976-77		1954	
1973-4		1164	
Differences 1976-77 versus 1973-74			
		790	40%

Table 22b

Hypothetical Pattern of Family Status Showing How An Average of 1.5 Dependents is Likely

Family Status	Accompanying Deps.	No. of Deps. In Sample of 100
Unmarried 30%		
Single 20%	0	0
Divorced 8%	0	0
Widowed 2%	0	0
Married 70%		
Childless 14%	1 wife	14
Children all adult for 7%	1 wife	7
One child, 14%	1 wife, 1 child	28
Two children, one adult for 7%	1 wife, 1 child	14
Two children for 21%	1 wife, 2 children	63
3 children for 7%	1 wife, 3 children	28
Total dependents		154
Average dependents per 100 transferees		1.54

The American international firm which purposely transfers Britains to the US rather than Americans to the UK to save on costs is investing preferentially in British national's competence just as much as if it were a British firm.

British companies, on the other hand, clearly are not investing in transferring American employees to the UK after their purchases of American firms since the number of Americans working in the UK has not increased.

The US-UK Economic Balance

During the relevant period the US-UK economic balance -- though still favorable to the US -- has shifted to Britain's benefit. The balance of trade pre-1975 was about 17% in America's favor; it has now slipped to 6%. (Revert to Table 18). The oddity is that Britain is reputed to have a weak economy, does have a poor balance of trade, and is often said to be hide-bound, even xenophobic, in business affairs.

The irony is even greater in that the US presence in Britain is still far larger than the British in the US. There are 200 major American companies in the UK and only 115 major British firms in the US as of 1976.

Despite these differences, Britons transferred into the US now almost equal American workers transferred to the UK and British business trips to the US have increased relative to American ones to the UK. (Revert to Tables 20 and 21)

The UK versus US Tax Situation

British employees transferred to the US enjoy considerable tax advantages over American transferees going the other way. The British meet a lower income tax rate than they have at home, are forgiven all home income tax if they are away their fiscal year, and are not subject to capital gains tax realized while abroad. Shorter absences from the UK also attract pro-rated income tax forgiveness. And they enjoy the benefits of the reciprocal treaty on foreign tax credits just as US citizens do. (Working Abroad, 1979 the UK Daily Telegraph Guide).

An American worker going to the UK meets a higher rate of tax than at home and also pays tax back home too. Either the American has to accept a cut in his income to work abroad or his company has to absorb the costs.

The situation makes the American automatically a more expensive or a more reluctant transferee than the Briton.

The statistics of international migration show that the situation leads to genuine effects; fewer Americans are working in the UK 1975-1979 and more Britons are working in the U.S.

PART II

THE WORLDWIDE DATA

US statistics give parameters on worldwide business travel by Americans. The information is indicative, however, not definitive. It should be considered an approximation of trends and changes, not an absolutely accurate representation of them. The real situation may be somewhat better -- or somewhat worse.

It was necessary to present the British data first because it is so much more complete and more detailed than the US emigration data is. (This problem besets all statistics on migration; information on people coming in is always more accurate than information on people going out.)

The validity of the US data is established by the fact that it and the British data closely coincide. The similarities are manifold: 1. Both show a similar decline in long term postings overseas; 2. Both show the rise in business trips; 3. Both show a change in short term stays; 4. Both show a similar distribution in the duration of business trips, with 33% or so of those staying more than a month staying overseas more than a year; 5. Both show long term postings running to periods of 2-4 years rather than one single year.

US Sources and Terms

The US Passport Service publishes "Summary of Passport Statistics" quarterly and an "Annual Supplement for the Year 19..". These indicate the number of passports issued by motives for travel (pleasure, business, education, etc.) and intended length of stay. They also provide information on which state travellers come from and on their occupations. They do distinguish between private and government travel. The information is available from 1973 on since in 1973 survey techniques were regularized and improved -- a lucky accident that both this publication and the UK data on work permits were reformed in the same year and prior to the tax change.

The data reveal only an approximation since it is not complete. Passports being valid for 5 years, it cannot represent the entire spectrum of change. The survey which produces the data is a survey only, not a total count; it gives only rounded figures. Because citizens are not obliged to indicate the motive or duration of their trips, there are large numbers of travellers of whom we know nothing at all. Up to 23% of passport recipients' motives are "Not Stated", and from 10% to 14% of business travellers do not indicate the duration of their stay. Thus at best the data represents only 20% to 33% of business travel in one year, and in every year there may well be large numbers of overseas transferees with intended duration unknown.

The data deserve credence as a representation of trends; it is internally consistent and it does correspond to established facts proven by British statistics.

The fact of internal consistency means that it is unlikely an undue number of long term business travellers are concealed in "Not Stated" or in "Duration Unknown". Table 23 shows that reticence as to motive does not fluctuate in such a way as to indicate unusual secretiveness by business travellers. Table 24 shows that approximately the same percentage of business travellers take trips of a given duration each year, so even with fluctuation in knowledge about duration, the trend over time will be clear.

The Annual Report of the US Immigration Service describes all entrants to the US by nationality and by sub-categories as well, such as immigrants, temporary workers and intracompany transfers. Intracompany transfers will be contrasted with US business personnel going abroad since they are the most relevant category to compare. Statistics also describe the number of dependents of intracompany transfers, and provide information on the number of shorter business trips. The most recent information available to the author in Britain is for 1977.

"US Citizens Residing in Foreign Countries" is issued annually by the Department of State. It is only an estimate, not a census or even a survey of Americans abroad. It does not distinguish between Americans who are not employed (the vast majority of American residents overseas) and those who are. It cannot be used to indicate, as some have tried to use it to indicate, that American workers overseas are not decreasing since it is only an estimate and since it takes no account at all of how many are working and how many are not.

The US Statistical Abstract has been used for data on foreign travel in general, economic statistics and sundry other factors relevant to the problem of overseas tax.

Statistics of Income 1975 (the latest data available from the IRS in the UK) has yielded information on foreign tax credits and payment of US income tax.

The Worldwide Shortfall of Americans Working Overseas

The total number of Americans sent overseas to work has decreased as much as and perhaps more than it has in the United Kingdom -- and with analagous timing.

There was a 19% decline (3,370 people per year) in persons applying for new passports to go abroad on business for longer than 12 months (Table 25). That would indicate a minimum shortfall of 13,480 workers going overseas each year, allowing for the fact that new passports perhaps represent only 25% of the valid passport use.

The pattern worlwide is almost identical to the pattern in the UK. The drop in long term postings occurs on the same chronological pattern with similar percentage declines, and is accompanied by the alternative policy of increased business trips.

Table 23

The Difference Between the Change in Per Cent of All Travellers with A Known Motive for Travel
And the Decline in Business Travel
Compared to the Previous Year
(Indicating Long Term Business Travellers are Not Unduly Concealed in "Unknown")

Year	% with Known Motive	Change in Known Motive All Travellers	Decline in Long Term Business Travellers
1978	81%	5%	-22%
1977	77%	-13%	-36%
1976	89%	-2%	-14%
1975	91%	-1%	+17%
1974	92%	-4%	+54%
1973	96%		

Table 24

Business Passports Issued By Duration, Including Those with Duration Not Stated 1973-1978.
(Numbers in 1000s)

Part I. The Number of Passport Issuances

Year	-1 mo.	1-2 mos	2-6 mos.	6-12 mos.
1978	109	9.2	7.1	4.1
1977	119	14.5	10.4	4.2
1976	170	22.3	16.3	6.9
1975	171	17.9	17.2	7.2
1974	173	21.6	14.9	6.8
1973	105	10.4	8.6	4.5

Year	1-2 Yrs.	2-4 Yrs.	4+ Yrs.	N.S.	Total
1978	3.4	8.1	.9	21.7	164
1977	6.5	8.4	1.1	26.8	191
1976	10.5	13.2	1.2	31.8	273
1975	12.2	15.4	1.5	31.0	273
1974	10.2	12.8	1.2	27.4	268
1973	4.7	5.5	.9	15.5	155

Part II. The Percentages by Duration

Year	-1 mo.	1-2 mos	2-6 mos.	6-12 mos.
1978	66	5.6	4.3	2.5
1977	62	7.8	5.2	2.2
1976	62	8.0	5.8	2.5
1975	63	6.6	6.2	2.6
1974	65	8.0	5.6	2.5
1973	68	6.7	5.5	2.9

Year	1-2 Yrs.	2-4 Yrs.	4+ Yrs.	N.S.
1978	2.0	4.9	0.6	13.2
1977	3.4	4.4	0.6	14.0
1976	3.9	4.8	0.4	11.6
1975	4.5	5.6	0.6	11.3
1974	3.8	4.8	0.4	10.2
1973	3.0	3.5	0.6	10.0

Table 25

Issuance of Passports for Long Stay Business Trips

Year	1-2 Yrs	2-4 Yrs.	4+ Yrs.	Total
1978	3430	8120	990	12,540
1977	6510	8440	1140	16,090
1976	10530	13190	1240	24,960
1975	12210	15420	1480	29,110
1974	10230	12790	1210	24,230
1973	4740	5470	930	11,140
Averages				
1977-78	4970	8280	1065	14,315
1973-74	7485	9130	1070	17,685
Difference 1977-78 versus 1973-74				
Per cent	-34%	-9%	-0.5%	-19%
No.	-2515	-850	-5	-3,370

Since the workloss per man runs to something more than 2 years per person, the effective decline is greater than the minimum estimate calculated on 1 year only per employee. The full yearly decrease is as much as 27,000 man years work per year on the assumption of a 2 year trip.

The tax modifications being proferred in 1978 had no immediate beneficial effect on the worldwide scale. The year 1978 saw a 22% drop over 1977 in worldwide intentions to work abroad for 1+ years. Conscientious though the Congressional efforts were to improve overseas taxation, they seem to have fallen short of the measures required to increase the number of employees overseas.

Since UK and worldwide patterns correspond so closely, it is reasonable to assume that many of the industries retrenching in the UK are also retrenching on a worldwide scale. If so, retrenchment is occurring in several major sectors -- agriculture, oil, mining, coal, chemicals, construction, professional and scientific, high level managers and engineers. If so, the worldwide retreat is continuing in 1979 as it continued in 1978. If so, American business overseas is less and less being carried on by resident American experts, and more and more dependent on foreign nationals or brief efforts by Americans on shorter business trips.

The worldwide data provides no information on overseas working residents returning home when formerly they would have stayed on. How many more employees are repatriating than usual after a year or more abroad is anyone's guess. If the discouraging effect elsewhere was as great as it was in Britain, the rate is something like 12% to 17% in excess attrition.

Evidence of the Influence of Tax

Taxation must be considered a significant factor -- in addition to any others -- in the decline of Americans working overseas, for they have declined more than other kinds of Americans abroad. The drop in long term business residents is greater than the drop in short term business trips by 5% to 15%. (Table 26) The drop in working residents is greater than the drop in nonworking Americans who intend to go abroad for longer than one year by 8% to 16%. (Table 27)

Given this data it is reasonable to believe that companies and individuals have indeed been discouraged by the change in tax status; the other problems of living abroad -- the high costs, mounting inflation, culture shock, social unrest and so forth -- are all similar for workers and nonworkers alike, for short term travellers and long term residents. Yet it is the long term overseas workers who have experienced the greatest decline.

The steady, steep decrease in long term business passport issuances suggests that the discouraging effect may have been worse on the worldwide scale than in the UK

Table 26

Decline in Long Term Business Trips Versus
Decline in Business Trips with a Known and Shorter Duration
(Passport issuance numbers in 1000s)

Year	Short Trips	% Over Prior Yr.	Long Trips	% Over Prior Yr.	Diff.
1978	130	-12%	12.5	-22%	-10%
1977	148	-31%	16.0	-36%	-5%
1976	216	+1%	24.9	-14%	-15%
1975	213	-1%	29.1	+17%	+18%
1974	216	+41%	24.2	+54%	+13%
1973	128		11.1		

Table 27

Decline in Long Term Business Travellers Versus
All Other Long Term Travellers with Known Duration
(Passport issuance numbers in 1000s)

Year	Others	% Over Prior Yr.	LT Business	% Over Prior Yr.	Diff
1978	119	-12%	12.5	-22%	-10%
1977	135	-20%	16.0	-36%	-16%
1976	169	-6%	24.9	-14%	-8%
1975	180	-4%	29.1	+17%	+21%
1974	188	+28%	24.2	+54%	+26%
1973	136		11.1		

-- when firms and employees contemplated less desirable locations and venues where business connections were more tenuous and costs even worse. The absence of rises such as occurred in the UK in 1978 when tax ameliorations were discussed tends to support this interpretation.

Industry has been reporting since mid 1975 that the change in tax status would have a deleterious effect. It looks as if that testimony was quite correct and accurate. Many firms are in fact cutting costs by skimping on sending Americans overseas and hoping that shorter business trips will be adequate substitutes for full time work.

The Prospect

The decline registered so far may not be the end of the trend. The GAO report of 1978 found that 60% of US head offices and 42% of overseas branches did indeed plan to reduce numbers working overseas if tax costs rose, but that many of these firms were holding fire until the final outcome was definite and firm.

If the companies are as good as their word -- and so far events indicate they mean to do even more than they say -- the number of Americans working overseas will diminish even further at a time when the US needs to increase its overseas efforts in order to improve its balance of trade

The Contrast of Worldwide Intracompany Transfers into the US

Foreign employees posted into the US doubled between 1973 and 1977 to the tune of 9,000 more in 1977, whether they were transferred by foreign or by US firms. There was a stasis in 1975 foreign transfers which contrasts with the actual drop in Americans transferring into the UK in that year. The gap increased after 1975 when foreign transferees increased while Americans declined. (Table 28)

The bulk of these transfers hail from highly developed nations, primarily from Europe, so it is potential competitors from sophisticated nations who are coming to the US in increasing numbers, not nationals from less developed areas who come to increase their expertise (Tables 29 and 30). Long term transfers, long enough to warrant bringing dependents along, rose 44% between 1973 and 1977 (Table 29) The number amounts to 4,395 long term intracompany transferees the year, estimating by 1.5 dependents per transferee as explained on page 22 and in Table 22b.

Some of the increase is due to foreign firms which are sending more nationals to the US after initiating or expanding investment there. The contrast to US firms lowering their overseas presence should not be ignored.

But much of the increase in transfers is likely to be due to the policy of US firms. There were 539 firms in 1976 in the US which were 50+% foreign owned. Each one would have had to transfer 19 long stay employees in 1977 -- an unrealistically high number -- to account for foreign intracompany transferees.

Table 28

Worldwide Intracompany Transfers into the US 1973-77

Year	ITCs Number	% Over Prior Yr.
1977	18,000	17%
1976	15,000	13%
1975	13,000	nil
1974	13,000	31%
1973	9,000	
Averages		
1976-77	16,500	
1973-74	11,000	
Rise 1976-77 versus 1973-74		
Number	5,500	
Percent		33%

Table 29

Estimated Rise in Long Term Intracompany Transfers 1977 vs. 1973
(Using Norm of 1.5 Dependents per Transferee)

Category	1973	1977	Rise
Total Deps.	8,505	15,098	
LT ITCs	5,670	10,065	
Number Rise			4,395
Per cent Rise			44%
Estimated Long Term ITCs for Selected Regions			
Europe	2467	5743	57%
Asia	366	931	61%
Africa	78	237	67%

Table 30

Rise in Intracompany Transfers for Selected Nations: 1973 & 1977
(Numbers include both short and long term transferees)

Region & Nation	1973	1977	Rise
Europe	4,927	10,205	52%
Austria	66	123	46%
Belgium	109	167	35%
Denmark	37	99	63%
France	402	994	60%
Germany	634	1,297	51%
Italy	269	618	56%
Netherlands	211	741	71%
Sweden	259	503	48%
Switzerland	136	413	67%
Asia	898	1694	47%
Japan	391	630	38%
Phillipines	113	179	37%
Africa	147	422	65%
S. Africa	60	154	61%

The change in transfers is not a mere faddish preference for foreign employees by US owned or foreign owned firms. Hiring of foreign workers who are temporary or trainee workers shrank by 20% in the relevant period.

It looks then as if US firms are favoring foreign employees when they are budgeting for filling high level international positions in US head offices. It is not merely that they have, as rumored, sent fewer Americans abroad and hired more foreigners abroad, but that they are also posting more foreigners into the US as substitutes for Americans with international experience.

In the short run this may mean more imports to the US since foreign employees, like US employees, tend to buy their own familiar national products when in a position to do so.

In the long run, when the foreign employees are repatriated, it means there will be fewer people in US head offices who have a profound sense of how to deal with foreign markets.

Meanwhile the foreign national transferees will ordinarily return home endowed with greater knowledge of how to approach the American market. That knowledge will not always invariably remain within the American owned firm.

In itself there is nothing at all wrong with increasing the number of foreign employees learning international business in the US.

The problem is that at the same time fewer Americans are accruing international experience abroad.

International Business Trips

Business trips into the US rose by 35%, an additional 242,000 a year, between 1973 and 1977. Thus short term contact as well as long term residence is being increased for the rest of the world in the US. (Table 31)

There is no way of reckoning whether US business trips abroad have increased as much as, more than, or less than worldwide efforts into the US since a vast number of trips can be made on extant passports.

The little evidence there is suggests that US increase in business trips may be less than the increase of foreign business trips into the US. British trips to the US rose 34% while US trips going the other way rose only 15%. (Revert to Table 21) The passport data suggests a decline in training of new American business travellers because fewer new business passports are being issued in 1977 and 1978. The overall number of passports being issued for business trips in the first instance have decreased by 7%, but this shortfall may be accounted for by the general 1T% increase in valid passports. (Table 32)

Summary

In order to cut costs in a decade of economic stringency and to meet extra costs through increased income tax, US firms have decreased posting American personnel overseas on a worldwide scale. It looks as if they are also transferring more foreign personnel into the US with the savings made. The annual estimated balance works out to 26,960 fewer man years of work by Americans abroad, and 8,800 additional man years of work by foreign employees in the US, assuming 2 years of work per long term overseas transferee.

Even if every last single foreign ITC worked for an American firm -- which is unlikely -- the balance of 13,000 fewer Americans abroad versus 4,000 more foreigners in the US means thousands of years of international export work have been lost to US industries, and that thousands fewer in the US resident workforce know how to deal with foreign markets from having had experience abroad.

If the majority of the additional foreign ITCs coming to the US work primarily for foreign firms, then most major trading powers are increasing their efforts in the US at the very time that US industry is diminishing its efforts abroad.

However the statistics are interpreted, the main trend is fairly clear. In the second half of the 1970s, thousands fewer Americans worked abroad each year and thousands more foreigners worked "abroad" in the US, even though those other nationalities faced the same worlwide economic problems and local American problems in the US that American firms and workers do. It is only Americans who are liable to overseas income tax, and it was when proposals to increase their liability arose that the number of Americans working abroad decreased.

Table 31

Business Trips Into the US 1973 – 1977

Year	Trips	% Over Prior Yr
1977	684,000	15%
1976	584,000	10%
1975	527,000	-3%
1974	544,000	19%
1973	442,000	
1973 vs 1977	242,000	+35%

Table 32

Extant Passports Issued for Business Trips at First Instance Compared with All Extant Passports (Totals for Present and Previous 3 Years)

Year	All Business Pps.	All Extant Pps.
1978	901,000	11,400,000
1977	1,005,000	10,600,000
1976	969,000	10,200,000
(Pre-1976 data not comparable)		
Difference between 1976 and 1978		
	-7%	+11%

PART III

A MATTER-OF-FACT SKETCH OF AMERICANS LIVING ABROAD

Americans living overseas -- whether working or not -- are assumed to be a lucky few inhabiting the never-never land of the tourist brochure.

Analysis of available data indicates a more run-of-the-mill pattern than that. Some of their statistical characteristics are relevant to the issue of overseas tax.

How Many Are They?

The overseas working American is not an outright rarity, nor are nonworking Americans abroad. The total population is estimated to be around two million or nearly 1% of the population of the US.

The income earning Americans approach being 250,000 in any one year. Over a decade they are likely to amount to half a million.

If export effort overseas increases, the number will be even greater in the future.

There were 234,000 Americans who claimed foreign income tax credits when filing their income tax in 1975 according to the Treasury's Statistics of Income 1975 -- a number much larger than the 155,000 estimated by the Treasury in its special study of those who claimed the exclusion in 1974 -- a study against which tax changes were in part analysed. This extra 79,000 show up in the very year when overseas workers began to diminish, so in other years they would presumably be more than 234,000. Among those who did not elect to take the exclusion will be thousands ineligible to take it since they have not yet lived abroad for the full tax year, more thousands who returned home in a miss-timed year, and still others who did not take the exclusion for other complex practical reasons or because they preferred alternatives since the real value of the exclusion had declined.

There are probably several thousand further workers overseas who fail to file because: 1. Some are outright evaders; 2. Others presumed their liability ceases abroad or that payment of foreign tax sufficed, having been mis-advised by ill-informed foreign accountants. (US tax advisers are rare and expensive abroad.); and 3. Still others presumed that since their income was below the exclusion, they had no need to file, which is a regrettable but easily made error. The author found 4 people in categories 2 and 3 among 50 people questioned in a straw poll. (No one admitted to outright tax-dodging.)

A confirming approximation of 250,000 workers can be reached through business passport statistics. Table 33 shows that in any given year a minimum of 248,000 persons are likely to have had long term employment overseas; the estimate is based on the minimal assumption that new passports represent 33% of all passports used, when in fact they could represent as little as 20%.

The estimate of up to half a million working overseas long term in any decade is based on the fact that passports are valid for 5 years. (Table 33)

How Many Have Short Term Overseas Work Experience and Could Thus Begin Long Term Work Well Prepared?

The potential number of overseas workers who have gone abroad on some sort of business before is something between 2 and 4 million Americans. These are the number who are likely to have been abroad on shorter business trips before within the last few years. (Table 34)

Given the right conditions, the small constituency of overseas employees could quickly become a larger one.

The very fact that overseas earners, even at 250,000, are such a small proportion of the US workforce suggests that their numbers should be encouraged to increase. Critics of overseas tax reform use their sparseness as a reason for dismissing their claims. But what is a large industrial nation like the US doing with such a small overseas workforce if it is indeed in need of increasing export?

The States of Origin

The majority of business travellers --60% -- come from States which are not massive economic giants. The 2 to 4 million business travellers are a relatively representative group as far as regions and states are concerned. (Table 35)

If tax is discouraging long term overseas postings, it is discouraging industries already trying to export from all the regions and states of the US, not just a select few.

The High Income of Overseas Earners

The overseas workers are well paid. As the Treasury pointed out in the 1975 study on exclusion, the income averages $30,000 and is thus well above the US median.

That high income occurs because the brain drain works both ways. Foreign nations only allow an alien to take employment if he is a highly qualified worker for the most part. Firms only send workers abroad if they are experienced and competent enough to make the transfer costs worthwhile, and those are estimated to be $20,000 to $30,000 on average. Typically the overseas employee is a professional or managerial male college graduate between 30 and 60 years old (or a highly skilled craftsman) who works full time and year round -- the prime earning group in the US, whose median income in 1975 was $22,000 to $29,000. The overseas worker earns somewhat more than he would at home, but not much. The overseas earner is not highly paid because he happens to be overseas. He has been and will be equally highly paid -- and taxed -- in the US.

Treasury data seems to indicate that the level of income overseas is set in accord with local costs. The 1978 analysis of 1975 income by nation of residence showed

Table 33

Estimate of Long Term Workers Overseas (Last Four Years' Worth of Long Term Business Passport Issuances, Assuming New Passports Are Only 25% or 33% of Total Passport Use)

Year	Issuances Number	Full No. At 33%	Full No. At 25%
1978	82,700	248,000	331,000
1977	94,400	283,000	378,000
1976	89,400	268,000	358,000

Table 34

Estimate of Passports Used Sometimes For Business Travel

Year	Business Pps. Issued Number	Full No. At 33%	Full No. At 25%
1978	901,000	2,703,000	3,604,000
1977	1,005,000	3,015,000	4,020,000
1976	969,000	2,907,000	3,876,000

Table 35

Origin of Business Travellers (All Durations) By State and Region: Newly Issued Business Passports Only. (Numbers in 1000s)

	NE	NC	Pac.	S. At.	SC	M
Number by Region						
1978	43.3	32.5	35.0	24.0	21.1	7.7
1976	77.2	54.7	53.8	37.4	38.2	10.7
Percentage by Region						
1978	26	20	21	15	13	5
1976	28	20	20	14	14	4
Total and Number from Four Major States						
Year	Total	NY	Ill	Calif	Tex	Remainder
1978	164	19.1	8.2	27.6	11.3	98
1976	273	32.8	13.9	43.9	20.2	162
% Not from Four Major States						
1978	60%					
1976	59%					

that in Canada and Mexico income was not as much above the US median as elsewhere in further flung and less comparable nations. Firms are probably not paying automatically higher salaries abroad but calibrating income to expenses and overseas needs.

A significant portion of overseas workers are not highly paid. Twenty-five per cent earned less than the US median in 1975 according to the IRS. The lower paid may be even a larger proportion than that given the fact that they are more likely than others to have failed to file, being cheaply and erroneously advised by foreign accountants, or assuming foreign tax credits and/or the exclusion covered them.

Fringe Benefits to Cover Overseas Expenses

Overseas workers do not necessarily enjoy many or even any fringe benefits. Half of them are economically protected from the financial problems of working overseas; the other half are not. Thus they are not overwhelmingly the spoiled minions of generous firms. The GAO study for the 1978 hearings questioned a small but worldwide sample of individuals and firms. It found fringe benefits, but fewer than one would have presumed.

Twenty-five per cent of overseas workers receive no extra benefits of any substance whatsoever, not even employers' contributions toward home leave. Some firms, to the author's certain knowledge, even fail to pay the promised repatriation costs.

Fifty per cent of the overseas workers do not receive any cost of living allowance or any other premium for being abroad. Presumably most live in the 38% of foreign nations where costs are less excessive as reckoned by the IRS. But not all of them will be in the cheaper spots. Overseas workers have no way of knowing in advance precisely what costs and conditions they will meet when they are recruited in the US. They may be able to bargain with their employers, but often they do not know what they are bargaining about.

Not all overseas employers, after all, will be as exemplary as those who take the trouble to testify to Congress about the problems of working overseas.

Fifty per cent of the overseas workers do not get their tax burden covered by their employers either -- whether their tax problem be with the country of residence or with the U.S.

What Size of Firms Do They Work For?

Roughly 20% are independents, 30% work for moderate sized firms, and 50% are employed by firms with a large scale program of benefits, which suggests it is a large scale firm, or a firm with a large number of employees overseas. This estimate is based on the GAO's reporting that 77% of firms do provide assistance with tax, but only 50% of income earners report any employer assistance with tax. The data is admittedly shaky, because the sample is small, but at least it provides some approximation of what kinds of firms are abroad by percentage of employees, and how many taxpayers are enjoying fewer fringe benefits than they are presumed to have because of individual company policies or because the taxpayers are independents.

The Tax Dilemma

That half of the overseas labor force which gets no company assistance with tax will either be taking a cut in their income or deciding to return home.

The 77% of firms which help their employees with tax will either absorb the cost of the tax or transfer it into higher prices in the market place or cut down on American personnel overseas.

The data indicates that many firms prefer to send fewer Americans abroad and prefer that some of those employees long abroad return home earlier than they otherwise would.

Do American Earners Overseas Pay US and Foreign Tax?

Overseas earners do pay US income tax despite the impression given by the term "exclusion" that they do not. Of the 234,000 who paid foreign income or partnership tax in 1975, only 9% paid no income tax in the US as distinct from 24% of American residents who filed non-taxable returns. The 9% abroad who were non-taxable had typically paid $3,700 in foreign income tax; the 91% who paid US tax had also paid $1400 to a foreign government. (Statistics of Income 1975)

Tax dodging in their foreign nation of residence also looks to be rare since so many can claim foreign tax credits. This fact is mentioned only because media snippets often imply that tax gimmicks are routine and usual abroad and that few overseas workers pay anything at all to the nation of residence. The evidence suggests that most do pay foreign tax.

Is It Easy to Evade US Tax?

When an overseas American returns home to the US after a long period abroad, which can be seen from his passport, the officer who admits him checks his name with a computer before he can pass the barrier. Only after the computer has given an all-clear is the returnee told "Welcome home!" and allowed in. Thus there is a surveillance mechanism which should make it difficult to evade tax if one ever returns home again even for a quick visit.

Perhaps the IRS could provide information on the extent of overseas tax evasion if that is deemed necessary, for in their records they must have information on the extent of evasion which occurs.

The Life Style in General

Working abroad is an unusual and infrequent opportunity without any doubt, and it offers special experiences too.

The enviable experiences are two: 1. The chance to live in a foreign place where most Americans would not be allowed to take work and could not afford to live on their own without work; 2. The chance to visit further distant places at less transport cost than resident Americans pay. Some of the strings attached to these benefits and some of the special experiences are far from enviable.

Work is still work even overseas. The employee transferred abroad finds himself in a new job in unfamiliar circumstances so he has to work hard, probably harder than he did in the US.

Working abroad is more insecure than it is in the US. Employees abroad have fewer opportunities since legally they cannot change jobs even if they want and rarely are other openings available on the spot. The small number of hirings (the permissions) in the UK demonstrate this point. Most employees are out of touch with opportunities at home as well. Some, if they or their company fail, find themselves without the right to look for another job without moving a very long way indeed. A few become refugees.

Living abroad, after an initial period of romantic enthusiasm causes stress and sometimes panic and flight. Premature repatriation because of genuine discontent runs from 25% to 40% (Businessweek, April 16, 1979). That is as steep as the current US divorce rate. Even those who stay on express disenchantment. Executives polled in Europe report that most capitols are less agreeable places than New York -- which itself is not everyone's dream. (This discontent was reported in a 1980 survey by Management Centre, Europe, a branch of the American Management Association.) It shows that the grass definitely is NOT greener outside the US.

The standard of living is lower than in the US. Even in the richest capitols, Americans overseas find that their standard of living slumps. They can only procure for themselves what is available, and less of everything is readily and cheaply available than in the U.S. For instance, "luxury housing" in Europe has gimcrack plumbing not to be relied upon; the overseas worker can easily become a bathless wonder no matter how much he pays in rent. Many of the practicalities of day to day working are equally problematic. The toll of costly inadequacies mounts up. The GAO study, it should be recalled, reports that only 50% receive allowances to help pay for "luxuries" which would be "basics" in the US.

The Life Style in Britain

As the third largest enclave of Americans living abroad, Britain can provide a fair notion of how Americans live in the more desirable foreign locations. The statistics indicate they do not fulfill the media image with which they have been endowed. (Since the statistics on life in Britain cover all overseas Americans, what follows is for the most part a picture of the general life style. In some instances further data provides a more specific image of the employed American overseas.)

Most Americans do not live in the glamorous locations. For those who are employed the place of residence is dictated by the place of work. Tourists would not visit many of these places unless they were the most dedicated of sociologists. Of the 110,000 Americans counted in the 1971 Census (the last available residential data) only 25% lived in Greater London, and that includes miles of cramped suburbs. The other 75% were scattered across the nation. Twelve per cent lived in depressed areas -- Scotland and Wales.

They are subject to serious surveillance as aliens. They must register periodically during their first four years with the Home Office whether they are work permit holders or not. If they fail to register, or if they move without notification, they find angry officials at their front door. Working Americans are obliged to renew their work permits annually as well. They are not allowed to change jobs or to start any business of their own without special permission. Dependents, be they wives or grown children, are discouraged from taking up any kind of work that a local citizen might take instead.

Americans living in Britain do not travel outside it much. They are not using it as a launching pad to see the rest of the world. On average there are only 1.3 trips outside the UK per person per year -- business trips and home leave included. (The Home Office data records re-entry of all alien residents after temporary trips outside.) Typically the 136,000 estimated to be there make 160,000 returns a year even though continental Europe is nearby and a trip there is the equivalent of an out-of-state journey in the US. (Table 36)

Home leave is not an automatic matter of course either; the re-entry figure of 1.3 suggests it is not even necessarily commonplace. Home leave depends on the pressures of work and only happens if and when the employee has spare time. Often it is more expensive for the American abroad to visit the US than for tourists to travel the other way since the employee has to go on short notice and cannot pre-reserve bargain fares or off-season trips. For the 25% in the GAO survey who must finance home leave entirely on their own, costs may make annual leave out of the question and totally impractical.

Overseas workers do not stay abroad forevermore. The business passport data showed that the usual stay lasts 1 to 4 years and rarely more. (Revert to Table 24) The UK Census data shows that among all American residents, approximately half return home in each succeeding year, since only half as many remain as were present in the previous year. (Table 37) Close as the US-UK relationship is, few Americans choose to settle in for a long stay once they have given it a try.

Nor do Americans in Britain become more British than the British or change their citizenship. Only one half of one per cent of those who are eligible to take out British

Table 36

Re-entry of American Residents to Britain After Temporary Trips Abroad
(Using State Department Estimate of 136,000 Residents)

Year	Re-entries	Trips per American
1978	182,000	1.3
1977	173,800	1.3
1976	171,900	1.3
1975	162,400	1.2
1974	161,300	1.2
1973	149,900	1.1

Table 37

Half of American Residents in the UK Depart For Each Succeeding Year of Residence (1971 Census)

Residents' Duration of Stay	Number
1-2 yrs.	39,000
2-3 yrs.	19,300
3-4 yrs.	11,800
4-5 yrs.	5,200
5-6 yrs.	3,800
6-7 yrs	2,600
7-8 yrs.	2,300
8-9 yrs.	2,000
9-10 yrs.	1,700

Table 38

US Citizens Renouncing US Allegiance and Becoming British Subjects

Year	Number
1978	24
1977	52
1976	40
1975	72
1974	77
1973	78

citizenship do so -- fewer than 100 Americans per year. (Revert to Table 38). On the contrary, Americans in Britain become more acutely aware than ever before of how thoroughly American they are.

Summary

The composite picture of the American workers overseas looks like this:

They probably number about 250,000 hailing from all the States of the Union. Most are well paid but no better paid than they would be in the US; 25% earn less than the US median. Fringe benefits to cover overseas costs are less frequent than one would presume and suggest that 30% work for moderate sized firms and 20% are independents. Once abroad, their standard of living drops. The place of residence is usually dictated by work and subjection to surveillance is common. The right or the chance to change jobs is restricted. They stay abroad 2-4 years and have no hankering to change their American allegiance. A longing to repatriate is frequent, and at least 25% return home before their contract is completed. Those who stay do pay US income tax and foreign tax as well. There is not a great deal of further travel for most Americans overseas. Inability to take home leave is common due to the pressures of actually doing a job.

To be sure, among overseas Americans there are shrewd tax dodgers, flamboyant super-stars, drug runners, and executives who practice bribery as their speciality, but such spectacular figures are as rare abroad as they are in the US.

For the most part Americans overseas simply do not live up to the raffish, luxurious image given them by novelists and films anymore than most Congressmen resemble the sensational media versions of themselves.

PART IV

PERSPECTIVES ON THE EQUITY AND RELEVANCE OF TAX REFORM

Several contentious debating points have held the limelight ever since the issue of overseas tax opened up in 1975. Since there is not much firm evidence on these points for either side, the arguments get repeated over and over again, and rarely does discussion look beyond the confines of the issues originally raised. The following sections, while also repeating the old arguments, have some fresh contributions and some new information to provide. Most, but not all, is frankly from the point of view of Americans overseas.

The Question of Equity

American individuals and firms working abroad have persisted in protests about overseas taxation because they are convinced they get the worst of both worlds. They are unique in the world in being taxed while working abroad, so they are unequal to any other foreign workers in the world with whom they compete. They are also unequal to American residents at home because they are not in a position to benefit directly from the tax dollars they have paid in the past or the tax dollars they pay while abroad.

What is at stake is a matter of costs and of costly morale. Morale itself is an import factor in anyone's work. Overseas it is also a serious aspect of costs because somewhere between 25% and 40% prematurely repatriate before their overseas assignment is complete.

The ways in which overseas taxation makes Americans abroad unequal to their foreign competitors and foreign citizen competitors in the same nation are:

1. When local citizens are the competitors, those local citizens have a greater right to use the local governments' business services than Americans as foreigners do. US government services abroad usually cannot compensate for that (nor are they expected to). But the American is thus receiving less back-up than his competitors do although he is paying two sets of tax. In developed nations, where much of US trade occurs, the local competition can be far more significant than foreign competition is.

2. The complexity of overseas taxation is a hindrance. Tax-wise employees expend a lot of effort trying to make their lives conform to the deductible patterns of life. Tax-naive workers find the system so complex it uses up a great deal of time. In either case energy and effort which could better be exerted on their work abroad is instead necessarily devoted to fulfilling the US tax requirements.

3. Americans abroad are less able than their competitors to make their foreign tax rate as low as it can legitimately be precisely because they are subject to two separate systems of tax which rarely coincide. Deductibles in one nation are taxables in another, so there is almost no way to achieve the lowest legitimate tax rate abroad and/or at home.

4. Americans abroad are automatically more costly because they are liable to tax at home while no other major nation taxes its nationals when they work abroad.

The ways in which overseas taxation of Americans is inequitable in comparison to US residents are as follows:

1. They do not benefit directly from the taxes they have paid in the past nor the taxes they pay while abroad as much as resident Americans do. Nor do they receive the protection of their rights abroad which American residents enjoy at home. Lack of these facilities affects their business efforts as well as the quality of their lives. Most Federal expenditure is within the US. Important facilities are inacessible because they are hundreds and even thousands of miles away, and their use by Americans abroad is sometimes hedged about by legislative restrictions. A few instances which affect business and personal life are listed in Table 39.

2. The rights and privileges of Americans abroad often depend upon reciprocal arrangements between the US and foreign governments, whereas US residents are not hedged in by such contingencies. Reciprocity does not prevail totally, however, when overseas citizens' obligations to pay tax to their home nation arises. Americans are obliged to pay tax back home; foreigners are not. The deductibility of foreign taxes for Americans abroad on a reciprocal basis only partly ameliorates the inequity, just as reciprocal conventions for rights and privileges so far only partly equalize the overseas Americans' status in comparison with US residents.

3. The overseas tax system has become ever more complex, while resident American's paperwork has been simplified.

4. The IRS seems to be even stricter with taxpayers abroad than it is with those at home. For instance, resident Americans are allowed to deduct many other taxes while those abroad pay but often are not allowed to deduct the rough equivalents of those imposts.

5. Americans overseas bear a double bureaucratic burden. Unlike residents they are subject to a host of unfamiliar taxes abroad. Time loss, harassment, and costs all mount up.

The issue of equity for American resident taxpayers from the overseas point of view, is respected because:

1. American residents are liable to greater income tax than Americans abroad, but American residents get the luxury, a genuine one, of living in the US.

2. American residents have more equitable tax vis a vis the overseas workers than any other national group since US overseas workers do pay tax while other nations' overseas workers do not.

3. Because income tax is progressive, it is those taxpayers at home who benefit most from export who compensate for leniency to taxpayers working abroad.

4. American residents are as eligible as overseas Americans to benefit from overseas tax regulations if they are willing and able to work overseas. Like Americans currently abroad, US residents would find, once abroad, that the expenses were greater than expected and the rewards rather less.

Table 39

Some Federal Services Less Accessible -- or Not Accessible at All -- to Americans Abroad.

I. Facilities that Affect Business Life

1. No protection against foreign competitors' corrupt or criminal practices by Federal Lawn Enforcement or regulatory agencies.
2. No Federal regulation of banking practices and guarantees on savings abroad.
3. Little access to the highway system or other forms of effective transport encouraged by the Federal government.
4. No protection by health and safety standards, hours of work and other fair employment legislation. (These can be significant for workers in hardship camps and for minorities, including women.)
5. Fewer insurance benefits such as Medicare and Unemployment Insurance if things go wrong, as they sometimes do.
6. Less protection from the Defense Department in the case of a major war even though the Armed Forces sometimes extract stranded Americans from hot spots.

II. Facilities that Affect Personal Life

1. No protection from the Food and Drug Administration
2. Less right to Veterans' Benefits such as VA hospitals and loans for education and housing.
3. Little access to National Parks or other programs providing cost-free environmental experiences and protection.
4. Little access to Federally-aided educational systems, including Land Grant Colleges.

III. Citizens' Rights and Redress

1. Few of the rights and guarantees in the Constitution and Bill of Rights.
2. No regional representation of overseas interests in Congress.
3. Access to Federal Courts impractical.
4. Citizenship of foreign born children problematic.

Equity and the Extra Expenses of Living as a Foreigner Abroad

There are manifold plagueing costs overseas that do not bite into the income of resident Americans -- in addition to the standard deductible costs such as international moving, higher house rent, home leave and the need for American style schools for American children, which were recognized in the 1978 tax reform. Some costs affect everyone everywhere; some costs affect everyone in some nations; some costs affect some groups of individuals only, or some nations only.

Any overseas transferee is likely to expend several thousand dollars within any one year on his particular set of necessary but non-deductible expenses. Table 40 lists the sample of extra expenses known to the author from the vantage point of Europe; there may be others which make serious inroads elsewhere.

A sample budget of the additional extra costs for one sort of family living at a moderate level in Europe for a 3 year stint is offered in Table 41. The estimate is only a cracker-barrel one, since it only fits one sort of family and makes stingy estimates of imponderables. For all its faults, the budget provides some measure of why workers overseas continue to repine about their tax. Something like 22% of their extra expenses are not covered by the 1978 set of deductions as they stand.

Improved tax regulations would mean that all overseas employees would be able to chose which extra expenditures they most need to make within the practical context of the local situation rather than merely taking those the law allots. Greater tax leniency would allow the 50% who are not protected by ample salaries and fringe benefits to buy for themselves what they most need or want, rather than trying to conform to the deductible life style systematized for those who are better off.

Large employers and well-off firms are complaining about the cost of tax and sending employees home early, and refusing to send more abroad to take their place. They represent something like 50% of the overseas workforce. The other 50%, the lower paid, those with less ample fringe benefits, those whose firms do not have an adequate program for overseas employees, those who are independent, and the self-employed also are genuinely feeling the pinch of tax, for they face costs beyond those currently recognized.

The notion that living overseas is a bargain-hunter's dream needs to be dispelled once and for all. The extra expenses are not balanced out by cheaper prices abroad. That contention, in the new world economic climate, is mere tourist business ballyhoo. The IRS 1978 cost of living indexes show that worldwide 62% of all nations are more costly than the US; among the remainder some will be an exact equivalent and a few will be cheaper than the US. Table 42 shows a range of extra costs in Europe as of 1978 strictly reckoned by the IRS and excluding housing and other itemized deductions.

Table 40

Nondeductible Extra Costs: Some Are Universal, Some Affect Everyone in One Nation, Some Affect Significant Numbers Everywhere

1. Buying locally essential domestic items of no further use on repatriation. For instance, usually all electrical items down to the last lamp in areas where the US electrical system does not prevail (or a transformer), and/or ordinary kitchen cabinets (France), and/or free-standing clothes closets (most of Europe) and so on and on. Most of these items cannot be resold.
2. Foreign nondeductible tax. They still pay Stamp Tax in the UK. They also pay VAT, TV Licenses, National Health Insurance (Socialized medicine is not free.), and Rates instead of property tax.
3. Costs and the costs of slowness in solving any stateside problems, whether they are legal or financial or other. Lack of American private sector infrastructure abroad is costly. In one instance getting correct checkbooks from a US bank took 6 months and 2 international phone calls.
4. Cost of keeping up professional expertize and contacts in two nations, including double memberships, subscriptions and conferences.
5. Cost of overseas communication, such as renting out or maintaining a house thousands of miles away, or keeping up US insurance coverage despite computer error; such errors occur more often because computers are not programmed to deal with workers overseas.
6. The expensive paperwork caused by being subject to several governments' laws and surveillance.
7. The high cost of political activity. The constituency is scattered and difficult to reach even in any one nation. It lacks access to electoral facilities on the spot or to free publicity through local media, because Americans are too few to be of interest to the media.
8. Need for new clothing to suit the local conventions and sensibilities. "Ugly" Americans do not succeed in business with foreign nationals.
9. Language lessons for all members of the family.
10. Driving lessons for adults; many fail to pass the local tests.
11. High cost of US oriented reading matter and information. Americans are not a mass market abroad.
12. Cost of bi-lingual doctors, secretaries and other advisors in non-English speaking nations.
13. Need for two home leaves in 1 year if there is a disaster stateside, such as floods, earthquakes, volcanic eruptions or a death in the family.
14. Repatriation often requires more than one trip home for those who need to obtain housing or a new job.
15. Need to provide own municipal services -- sanitation and security and so forth -- in less developed lands.

Table 41

A Very Crude Budget of Extra Expenses for an Employee in Europe on a 3 Year Assignment with a Family of 3 or 4

I. Extra Expenses Not Currently Deductible	
One-Time Expenses	
Locally essential domestic gear	$ 1,000
Driving and language lessons	500
Appropriate clothing for 3 or 4	1,000
One emergency home leave for a second time in one year	2,000
Pre-repatriation trip for 1 family member	1,000
Subtotal	5,500
Persistent Annual Costs	
Local nondeductible tax	1,000
Solving stateside problems	500
Extra communication costs	1,000
Obeying local government regulations	1,000
US reading matter and information	300
Dual-nation professional requirements	300
Cost of bi-lingual services	300
Annual subtotal	4,400
3 Year subtotal	13,200
Total 3 years of nondeductibles	$18,700
II. Currently Deductible Expenses; Cost of Living Omitted	
One-Time Expenses	
Moving back and forth 3 or 4 persons and household goods	$30,000
Persistent Annual Costs	
Extra Rent (GAO 1978 vs US Moderate Budget 1979)	7,000
Annual home leave for 3 or 4	2,000
Tuition for 1 child in private school	3,000
Annual subtotal	12,000
3 year subtotal	36,000
Total Deductible Expenses for 3 Years	$66,000
Nondeductibles as Per Cent of Extra Costs	22%

Table 42

Cost of Living Differences in Europe for a Family of Four Allowed by the IRS in 1978

Nation	1 Year Costs	3 Year Costs
Britain	$ 300	$ 900
Austria and Sweden	$ 8,400	$25,200
Switzerland	$13,700	$41,000

Equity and the Problem of Limited and Itemized Deductions

Congress and the IRS face a complex, tedious, and costly task in trying to make definitive legislation and/or equitable rulings on taxation of earned income overseas because:
1. Conditions in more than 140 nations are involved, and
2. Conditions in each nation fluctuate year by year, and
3. Other nations' tax systems are quite different than that prevailing in the US, and 4. The legitimacy of any deductions as a genuine need varies from nation to nation, and 5. The number of potentially legitimate deductions worldwide is large; if allowed in all nations they would allow undue advantages in some.

On the other hand, a pared down, limited set of deductions which fails to allow for special local problems or individual difficulties is likely to discourage many potentially productive transferees from going overseas precisely because it is inequitable for them or for their destination. For instance, the current set of deductions nicely covers many of the problems of well-paid employees who rent a house, enjoy fringe benefits and have a child attending a private school -- forgetting for the moment the 22% of additional expenses which it ignores. The deductions do not fit at all well the 50% who are less well paid, and/or enjoy few fringe benefits, and/or are self-employed, and/or prefer to buy rather than rent a house, and/or have language problems, and/or happen to be supporting a dependent parent in a nursing home in the US.

Alternative taxation legislation which overcomes the morass of difficulties inherent in a limited set of deductions has been proposed. Its effects will be discussed in Part V.

Perspectives: The Relevance of Tax Reform

The question of the relevance of tax reform to improving US exports is as significant as the problem of equity for Americans at home and abroad.

Do Americans Abroad Increase US Export?

There is no massive proof available on either side of the debate as to whether Americans overseas increase export, but what evidence there is suggests that they do.

It must be patently obvious that some workers overseas increase US exports. Those who sell abroad, those who service abroad and maintain the US reputation for quality, those who order US goods for their firms, those who discover and nurture new markets, those who design products to suit foreign needs, and those who initiate further or better export programs when they return to the US -- all of them increase US export.

Others are purchasing imports. Even they may contribute to improving the US balance of payments by purchasing wisely and keeping transport costs low. Importing firms usually prefer the solvency of their US head office to the solvency of a foreign branch. If their imports are purchased by an answerable American they are more likely to be carefully controlled than if they are purchased by a foreign employee or foreign purchasing agents, whose interests are not so irretrievably tied to those of the employing American firm and the US.

The British data does indicate on a small scale that the number of overseas workers does favorably affect their own nation's balance of trade. During the years when British employees increased in the US and US employees diminished in the UK the trade balance shifted to Britain's benefit.

On the worldwide scale the US still has vastly more to sell the rest of the world, including the developed world, than she needs to buy abroad for herself -- with a few exceptions. If more American workers were abroad finding and pursuing prospects, exports probably would increase.

Reasons Why American Personnel Should Specifically Be Encouraged to Go Overseas.

1. The American workforce is one of the natural trade advantages of the US. Few nations have such a large, diversified pool of well educated highly energetic workers to draw upon. American employees are costly but their quality is high.

2. American employees posted overseas are of more benefit than foreign employees in the same post in the long run. The American who returns to the US for the rest of his worklife provides a resident employee who knows how to trade abroad. Neither the foreign national abroad nor the foreign national working for a few years in the US serves US export in the long run as well as the American does. More foreign employees means fewer lifelong internationally experienced experts affecting policy in US head offices when export is in question.

3. Hiring an American rather than a foreign national allows the foreign nations to conserve their own experts for their own efforts. In nations where there is a shortage of skills, hiring foreign nationals is a form of on the spot brain drain.

4. Americans are especially necessary for founding new branches or entering new nations for the first time. New ventures tend to require several Americans for a few years until the venture gets off the ground; the Americans are needed to make sure it stays on the right track.

5. Resident employees are often more effective than personnel sent on shorter trips. THe man who makes repeated business trips, expert though he may be, seems something of a Johnny-come-lately, fly-by-night to his foreign contacts. He cannot exercise the same persistence and finesse which a resident American can. Residents make wider contacts, see more opportunities and learn how to proceed within the foreign context and conventions. In nations where the decision process is quick, residents are on the spot at the right time; in nations where decision is slow, they are present to encourage it along.

6. International trade requires that people of both nations be present in both places because each nationality has its own inerradicable character. The greater the number of contacts, the more business is likely to increase. If there is inadequate long term personal contact, ignorance, prejudice and incomprehension are likely to inhibit trade.

7. American firms sometimes find it easier to meet their own specific needs with American personnel. Firms sometimes make mistakes with their American employees; they make even more mistakes with foreign ones.

8. Even the experts agree exports and jobs will increase in the US if more Americans work abroad. The estimates range from the miniscule to the magnificent. The truth probably lies somewhere between those extremes.

All these reasons demonstrate why there is some necessity for and advantage in sending Americans abroad to work.

The converse policy -- of more short journeys and business trips, of hiring foreign nationals abroad and into the US -- has been in effect since 1975. It has not improved the American balance of trade.

Foreign Firms Entering the US Find Greater Advantages Than US Firms Entering Markets Abroad

There are several ways in which American firms are at an automatic relative disadvantage abroad when compared to foreign firms entering the US. Those disadvantages can discourage export.

1. The US market is bigger and richer than most foreign markets. US firms realistically have smaller expectations abroad than foreign firms have in the US. It is thus more worthwhile for foreign firms to invest in trying to import to the US than it is for US firms to invest in trying to export abroad.

2. The infrastructure in the US is more effective than it is abroad. Overseas the marketing, transport and other facilities are frequently less adequate than they are in the US -- even in other developed nations. Setting up business in the US is thus easier than setting it up abroad.

3. Foreign firms find more of their own nationals to hire in the US than US firms find American nationals abroad. There are 2.3 million working age foreigners living in the US (1970 Census) and probably no more than 1 million working age private sector Americans scattered across the 140+ nations of the world. If a foreign firm in the US needs to hire someone of their own nationality -- be it for reasons of image or temperament or special skills -- they have a better chance of finding him in the US foreign population than the American firm conversely has of finding an appropriate American abroad.

4. US firms more often have to train their foreign employees than foreign firms have to train US employees because of the quality of the labor force. That increases costs.

5. US personnel abroad are costlier than they would otherwise be because of tax, while foreign personnel working for a foreign firm in the US cost less than they would at home because they are not taxed at home and typically meet a lower rate of tax than they would pay at home.

The Number of Individuals and Firms Affected by Export Incentives: At Present and in Prospect

There are 2 to 4 million resident Americans in all regions and states who already have experience as overseas business travellers.(Revert to Table 34) In addition there are the tens of thousands of repatriated employees who might be capable of instantaneous efficacy overseas if their firms were to return them abroad.

Moreover, there are 40,000 US firms who now export or are capable of export according to Department of Commerce data (Businessweek, April 10, 1978).

The 40,000 firms fall into 4 categories, all of which would benefit from incentives, but each in a different way.

1. There are 20,000 uni-nationals who have not yet exported but could do so. They face a harsher economic climate abroad now than they once would have done because costs and tax and competition have increased. They will need encouragement to make the very expensive step of initiating export efforts. They run risks that established exporters did not have to face when they launched out under the more propitious tax system of the past and the more benign economic climate of other decades.

It is unlikely, unfortunately, that this large group will be adequately represented in testimony on the problems created for export by overseas tax since they have little experience to testify from.

Nevertheless the needs and interests of these uni-nationals should be carefully considered, for they constitute the largest reserve of potential exporters in the US. Many of them are newer and moderate sized industries aiming at new markets with new products and developments; that makes their potential very great. Amongst them will be many firms who have only recently arrived at a size which makes export a practical possibility. It would be unfortunate if that growth potential, which once would have been bolstered by incentives, were to be blocked.

Taxation of overseas income is a definite deterrent to such firms. Most of them know well enough that beginning abroad does not produce quick returns and that there is a risk of loss. Once they look into the matter, they are advised that it is wiser to send several employees abroad rather than risk all on a one man venture, because many problems crop up all at once; then they are warned of the 25% to 40% attrition rate; then they learn of the higher costs of living of overseas personnel; then they learn that to provide fringe benefits leads to tax, and that in addition they will be expected to pay still more, paying tax on tax on maintaining a usual standard of living for their workers overseas. It is hardly surprising that they are deterred. The Sorcerer's Apprentice had fewer problems than they are facing, and that is before the uni-nationals consider the difficulties of finding premises and contacts and obeying all the novel regulations of foreign governments' laws.

Learning to do business abroad is like learning to swim; it requires a terrifying initial plunge and takes quite a while before the novice can be sure he can keep his head above water. With the current tax regulations, uni-nationals launching out overseas will be swimming against the tide.

2. There are many thousands of bi-national and tri-national firms knowledgeable about the general procedures necessary for effective international trade. At present perhaps 30% of the overseas workforce works for such moderate sized firms. In many instances these companies will be capable of speedy expansion of trade if they find it financible to expand in one or two more nations abroad, drawing upon their past experience for relatively quick effects.

3. There are probably some thousand internationals, large firms with many connections in effect. At present they are not increasing the number of their overseas American employees even though some of them would like to do so. The work permit and passport data indicate that most of them are retreating in the face of tax increase.

4. There are several hundred multinationals with large scale establishments worldwide. The data indicate that even these firms are not increasing their overseas personnel and that some of them are in economic difficulties overseas.

The shortfall of Americans posted overseas means that few firms are initiating export efforts, that few who now export are trying to expand, and that few bi-nationals or tri-nationals are entering new markets with an all-out campaign, and that even the international and multinational firms are in retreat.

Testimony from these industries will indicate that they would like to send more Americans abroad. It is only reluctantly that they have cut down on the overseas transfers in the face of spiralling tax costs. Congress would not have been so beset with objections to the overseas tax increase in the last few years if it were not true that firms and individuals with experience abroad sincerely believe there is a genuine value in sending American employees abroad to work, rather than using foreign nationals in their stead. If they did not believe that, it would not have been worth their while to protest.

The Safeguard Against Unnecessary Postings Overseas

There is little risk that firms will increase overseas postings wastefully or uselessly as a consequence of change in tax. Revenue from overseas earners will be lost only if transferring firms genuinely believe the overseas postings will prove profitable. Each overseas employee costs his firm far more to send abroad than his tax concession would cost the Federal government. Companies are investing and risking more on the economic value of the overseas employee than the government is. The firms' own interests thus will serve as a safeguard against needless loss through unwise or over-enthusiastic postings abroad.

PART V

THE REFORM OF OVERSEAS INCOME TAX

The Extent of Tax Modification Required

There is a need to restore tax incentives to encourage Americans to work abroad.

Incentives seem to be required merely to raise their number to its former strength, for the number of overseas workers remains low even after painstaking Congressional hearings in 1978 led to a set of deductions which in costly nations already exceed the $25,000 exclusion formerly allowed.

Hopefully overseas tax reform will be thorough-going enough to increase the size of America's overseas labor force, not merely restore it to its former level.

Hopefully the change will be great enough to entice uni-nationals to take the giant first step now, and to encourage bi-nationals and tri-nationals to accept new risks, and to enable internationals and multinationals to use the best manpower they can find.

Hopefully the change will be forward-looking enough to take account of the fact that competition will be ever more fierce as more nations develop more advanced industries of their own -- and comprehensive enough to take account of the varying swings of economic highs and lows.

Hopefully the new legislation will be accurate enough and durable enough to resolve this vexacious problem once and for all so that everyone concerned can get on with other tasks.

Should All Workers Overseas Benefit from Tax Reform?

Former reforms made careful but invidious distinctions between one set of overseas workers and another, such as between those in hardship camps and those in more comfortable, but far costlier places.

The hard statistics in this paper indicate that almost all industries, all sorts of personnel and all kinds of businesses in developed as well as less developed regions are on the decline. If the aim of tax reform is to increase export and trade, the reform should be universally applicable and not try to subdivide the overseas community into various more and less deserving groups.

Even those segments of the workforce who do not directly contribute to export do contribute to the export effectiveness of the US. For instance, American school teachers and attorneys are necessary to meet the needs of export workers. Newspapermen are vital to the US's interests worldwide. Most entertainers enhance the US image and encourage tourism into the US. All Americans working overseas meet similar economic problems abroad, and almost all work, whether directly or indirectly, to the benefit of the US.

Tax Reforms Currently Proposed Analyzed in Terms of the Effects They Will Have on the Size and Nature of the Working Population Overseas.

Three different proposals have been made: 1. A total exclusion of income earned overseas; 2. A substantial exclusion with a deduction allowed for extraordinary housing costs- and 3. Taxation identical to taxation of residents of the US (by opponents of the other two reforms).

Each of these three measures will have different effects on the number and nature of the workforce abroad and will have different activating effects on the varying kinds of US industries which might increase export.

Since the aim of the reform is to encourage export, these demographic effects should be taken into account. They will matter as much as the macro effects on revenue, the legal complications and the accounting and budget complexities which experts in those fields will undoubtedly describe.

How Many Individual Taxpayers Would Directly Benefit From More Lenient Tax, and For How Long?

As things stand now, up to half a million Americans work overseas in a decade, typically for a period of 1 to 4 years. Almost all of them find themselves and their companies in the anomalous financial problems the current set of overseas workers complain about. Any concessions will thus affect a significant number of people in the long run, but only for two or three years for most of the individuals involved.

The more appropriate and effective the overseas tax reform is, the greater the number who will be posted overseas, and the greater the number who will benefit from it.

Lesser tax liability abroad will be a brief experience for a significant number of taxpayers -- not a lifelong [illegible] for a rarefied few.

The Proposed Total Exclusion: No Taxation Whatsoever of Income Earned Abroad.

The total exclusion has the virtue of totally equalizing the competitiveness of American workers overseas with their foreign rivals as far as tax burden is concerned. That is the prime reason why it has been proposed.

The immediate consequence would be that firms would be enabled to send abroad either more expensive employees than they now send, or send more employees abroad at all levels without worrying about the tax aspect of their costs -- a simplification in manning which other nations' industries already enjoy.

The measure is certainly likely to increase overseas postings effectively and quickly -- more so than any other measure could -- since it removes the discouraging effect of tax and removes it in such a clear and simple way that no company interested in expansion could misunderstand.

High level, high powered, and senior employees sent overseas are likely to increase. So in many instances will moderately well paid younger employees if the money saved on costlier personnel is used to transfer middle level personnel as well.

The richest firms and the small uni-nationals are likely to respond more to this measure than to any other. The large firms will be able to fill many posts abroad with more Americans whenever they think them preferable. The uni-nationals will find the cut in initial costs very significant and will find that the total exclusion starkly simplifies the problems of planning and budgeting needed prior to taking the first step.

The other firms -- bi-nationals, tri-nationals and multinationals with tight budgets -- will benefit too on all the same counts, but on a reduced scale.

To the extent that these moderate sized firms are in competition with larger American firms abroad (and such competition does occur), they will find themselves at a greater relative disadvantage than any other tax system would create. If the largest, richest firms launched an all-out drive, other firms might find themselves seriously outnumbered and outclassed even though their own workforce had improved and increased. The cannier uni-nationals, as well as the moderate sized firms, would foresee this problem and might hesitate to enter markets where larger already established firms had a better chance.

The US resident workforce with past experience overseas will increase, thus leading to better export efforts in the future from head offices. But the amount of that increase depends on the age-range of those posted abroad. If the tax savings are expended primarily for senior employees, then the pool of repatriated international experts will not yield many years of effective work. If both younger and older workers are sent, then a genuine cohort of export experts will develop and become an enduring American asset in international trade.

The number of IRS employees overseas would decrease -- the only fiscal benefit involved. There would be no need for personnel to administer the tax system abroad since there would be no tax system at all.

The long run adequacy of this measure is unquestionable. A blanket exclusion clearly covers all cost rises for the indefinite future and allows for all contingencies in the world market no matter how fierce competition and/or inflation becomes.

Moreover, it should put a final end to any further objections to overseas tax from the private sector and free potential exporters to get on with their jobs unfettered by the unusual burden of tax.

Whether the measure would be durable from the Congressional point of view is not so clear, since it is an unprecedentedly generous concession. If it does not produce sensational results, it may be called into question very soon again. If it is enacted, it will have to be left in effect for several years so that the high investment involved

-- from the private sector as well as the government -- has time to turn to profit and mature. Otherwise the pattern of hesitation and withdrawal of the overseas workforce which occurred when the exclusion came to an end may recur. The balance of payments might be damaged by a sudden revokation of a total exclusion more than it would be by a continued burden of tax, if new programs are stopped short before they have had the desired effect.

For all its lowering of costs, the total exclusion would not be an unmixed blessing for the American community abroad. Industries and individuals alike are viewed with some suspicion when they are abroad even under the present system of tax, let alone a system in which they go Scot free as long as they are abroad and out of sight. Total exclusion may inadvertently increase legislative suspicion of the American community overseas. It would undoubtedly entice a few unsavory characters to move overseas, and they in turn may further damage the reputation of the entire overseas workforce, unwarranted though such denigration would be for the vast majority of those working overseas.

Industries abroad seek supportive services from the Federal government and individuals seek an improvement in their status and rights even though they are overseas. Such improvements in services and status are important on a very practical level and important as a matter of morale. Many of these requests from overseas have been rebuffed by legislators on the grounds that they are too expensive or too insignificant, or too illegitimate to be considered seriously at all.

If Congress were willing to grant a total exclusion on earned income overseas without increased prejudice against those who enjoy the exclusion, and if Congress would even with a total exclusion still remain willing to consider requests for other improvements overseas, then this measure would be most effective in increasing export and equalizing US competitiveness abroad.

But if the total tax exclusion induces greater suspicion and prejudice against firms and workers overseas, then the dollars saved on tax may not be worth the services lost, nor worth the effects on employees' morale.

The Proposed Substantial Exclusion with a Housing Deduction

A substantial exclusion accompanied by a deduction for extraordinary housing costs is the other major measure proposed. The exclusion is to be raised to $60,000 (comparable to the pre-inflationary $20,000 to $25,000 formerly allowed).

It would clearly more fairly cover the manifold unusual expenses than the present system and more aptly suit all sorts and conditions of taxpayers than any set of limited deductions alone could do. It would also provide an incentive for working overseas, except in the very costliest lands.

The limited exclusion has been the traditional method of tax leniency and incentive to workers overseas. Its abolition was mooted in 1974 because the Joint Economic Committee then reconsidered many long standing tax incentives in the hope of finding they were somehow no longer necessary at all. Estimates in 1974 as to the efficacy of the exclusion in encouraging postings overseas and export varied. Subsequent events, from 1975 on, indicate that the exclusion did indeed serve as an incentive and that its loss did discourage American companies and employees overseas. Hindsight wins again.

Restoration of the exclusion would be a quick, sure way to encourage increasing efforts overseas. It is a system of taxation with which US companies and employees are already familiar; it is a system which many of them explicitly prefer; it is a system which succeeded in encouraging working residents overseas in the past.

The Housing Deduction

The addition of a housing deduction makes the exclusion a better method of encouraging overseas postings than ever before since it protects companies and employees from the most unusual and/or rocketing costs when planning transfers which are to last more than a year, as most transfers do.

The housing deduction is thus a more effective measure than an even higher cash level exclusion would prove to be, and more durable as well.

In addition the housing deduction makes the exclusion more even-handed than it would otherwise be since it balances out some of the disparities between costs in one nation and another, and since it protects against wholesale attrition of the exclusion's value (and thus its efficacy) in the costlier nations. Its significance can be shown by the fact that for Tokyo the current permissible housing deduction can run to $25,000 for someone earning $50,000 a year.

If costs rise in the next few years, as they are predicted to do, housing alone could consume the full value of the exclusion in many places -- leaving no latitude for moving expenses, home leave, language problems, educational fees and so on -- let alone an incentive. The costlier lands are often fine export markets.

On the other hand, if prices should drop, housing ceases to be deductible so there is no automatic benefit for employees who can achieve a normal standard of living at a normal price.

Unlike the total exclusion, the substantial exclusion may not provide full cost coverage and an incentive for sending employees to the very costliest nations where every single item of living and working -- not just a house -- is extraordinarly expensive and likely to become costlier still over the next few years.

The substantial exclusion with a housing deduction will encourage a larger number of middle level employees overseas. It will also encourage more employees to be sent overseas earlier in their career. It thus guarantees growth in the long term export expertize of the resident US workforce since the repatriates will be younger when they return and have more years of work ahead in which to make the most of what they have learned.

Senior and high cost employees will increase as well, but not as much as they would with a total exclusion since the incentive for them is not so great and since companies will consider their tax problems more cautiously than they would with a total exclusion.

The increase in younger transferees will improve the quality of higher level and senior transfers later on. Within a few years companies will have a greater number of employees with overseas experience to send abroad for a second residency if required. Such senior second-time transferees will be more effective early in their stay than first-timers of the same level would since from the beginning they will know how to confront half of the problems they will have to solve.

The substantial exclusion will encourage independents and lone wolves -- who can be highly effective -- more than the present system of stereotyped deductions does.

The highest flyers -- whether firms or individuals -- would prefer a total exclusion since their aims, like the total exclusion, have no limits.

All categories of firms will find this system attractive, but the richest firms will like it less than others, since the large amounts they can afford to pay employees will still be subject in part to tax. The substantial exclusion will not deter them from sending essential senior men, but it will skew policy somewhat. Some firms undoubtedly will send middle level men rather than expensive men when they are in doubt as to who should tackle a particular task.

Uni-nationals will find this measure encouraging since it cuts the costs of sending abroad the sort of team which in the first instance is usually required. But if they want a very expensive employee to head their efforts, they may be caused to think twice before they start. The limited exclusion protects them, on the other hand, from being totally out-competed by the richest firms which are already established abroad and more easily able to send a larger number of very expensive workers if a total exclusion is allowed.

Bi-nationals, tri-nationals, and moderate sized international firms will benefit in much the same way that uni-nationals will.

The number of overseas IRS personnel will probably be about the same as now, for though the system is simpler to operate than the current one, the number of overseas tax forms to be processed will increase.

The measure maintains the principle of progressive taxation. Moreover, since they still pay tax, it will help to legitimize overseas employees when they request a wider recognition of their needs and rights, and when industry requests further measures in support of US trade abroad.

If legislators will extend additional services and rights to overseas individuals and firms only on the condition that they continue to pay US income tax -- even though foreign competitors do not pay income tax back home -- then the substantial exclusion is preferable to the unlimited one, for many of the potential services are of great practical use, and many of the rights and privileges individuals want are important for their morale.

Taxation Overseas Identical to Taxation of US Residents

Undoubtedly such a measure would increase the cost of overseas employees and diminish their number. If the 1976 and 1978 proposed stringencies led to a 20% drop, this measure would lead to a stampede.

The richest established multinationals would suffer the least, though they would pay the most in tax. They could cover the costs of the most essential Americans needed overseas even though they were subject to tax. Such firms would probably be able to hold some of their export market, but it is unlikely they would be able to increase exports, and possible that their share of many markets would decrease.

Other American firms would retreat. Very few uninationals would dare to take the risk of sending an initial team abroad.

The small number of overseas employees left would be of the very highest quality; only the most productive would be able to or would be allowed to remain.

The employees with low salaries, few fringe benefits or working for moderate sized firms would have to be doggedly persistent ascetics, for in most nations they would undergo a drop in their standard of living well beyond what most Americans would willingly accept. Such Americans working overseas would be a rougher, tougher breed. Roughness and toughness are sometimes -- but not always -- an advantage in international trade.

The overseas community's requests to the Federal government for recognition of rights and for additional services would look entirely legitimate. But the numbers involved would be so few that the overseas community might well be ignored.

Competitiveness would cease. Overseas workers would be paying more tax than their rivals and yet be working without the sort of government back-up competitors enjoy.

US export is likely to decrease under such circumstances -- especially since short business trips and short residencies have in recent years proved to be inadequate as substitutes for long term employees overseas.

The only compensations are that the private sector capital expenditures on export effort would decrease, that costly overseas IRS personnel would decrease, and that the IRS would be collecting a larger per capita revenue from workers overseas, though the total amount of revenue might be small.

Alternative Versions of the Proposals As They Now Stand

Each of the three proposals could just conceivably be modified in such a way as to improve their efficacy and/or equity and to prevent some of their untoward consequences.

The possible modifications are that:

1. If total exclusion is granted, it be granted only until a worldwide convention equalizes and regularizes overseas taxation for all nations' overseas workers everywhere in the world.
2. The deduction which accompanies the substantial exclusion might become a unified, comprehensive cost of living deduction set for each nation each year by number of dependents, rather than a deduction which puts a premium on housing to the undue benefit of some taxpayers, and the undue discouragement of those working in nations where housing costs are not the prime deterrent.
3. The substantial worldwide exclusion could become an exclusion set for each nation each year according to costs and by number of dependents as described in a comprehensive formula established by Congress with annual reckonings to be the work of the IRS.
4. Identical taxation of Americans overseas could come into effect if and when there is a profound reorganization of the US income tax, so that analogous and relevant deductions are allowed to every American everywhere in the world.

A Total Exclusion Until Other Nations Tax Their Citizens Who Work Overseas

If Congress were to consider allowing the total exclusion temporarily, but indefinitely, until other nations agreed to tax their citizens overseas, the principles of tax liability and of progressive taxation would remain while at the same time US competitiveness would be equalized.

This measure is not necessarily impractical. Conceivably it could be brought into effect by an international treaty negotiated by any one of a number of international agencies. The aim would be to see that all nations tax their high level and skilled workers overseas at a comparable and progressive rate, with incentives allowed. Undoubtedly such negotiations would be costly, complex and slow. In the long run they would increase US revenue and the revenue of other governments as well.

As long as incentives were allowed, international trade probably would increase. If the additional revenue worldwide were earmarked in part for support of trade, then international trade might increase more than under any other measure.

The Substantial Exclusion Plus a Unified, Comprehensive Cost of Living Deduction for Each Nation Each Year by Number of Dependents

If a unified, comprehensive cost of living deduction were substituted for the housing deduction, the effectiveness of the exclusion-plus system would be increased.

Such a deduction would comprehend housing and other on-going expenses as well, such as local "nondeductible" tax, the costs of bi-lingual living, and so forth. Under this system the exclusion is presumed to cover extraordinary one-time or infrequent costs such as house moving, home leave and the like, and to provide an incentive. The comprehensive annual deduction is to cover day to day costs when and where they become high.

Such a deduction would be more accurate than the housing deduction would. Housing is not invariably the only or even the most serious problem confronting Americans working overeseas. It received so much attention in testimony because it is the easiest dramatic high cost problem to describe. But the essential problem with costs abroad is that they mount up one by one. It is the total extra costs that are the problem in each nation, not only the widespread problem of very high rent.

Such a deduction would encourage firms and individuals to venture into any market where they thought they could succeed, rather than leaving them hesitant about places where there are extraordinary extra expenses aside from the cost of a house.

It would prove an incentive to Americans working overseas in areas where the exclusion-plus-housing measure might not prove adequate.

Such a system would allow overseas workers to buy what they really need instead of merely procuring what the law allows. For instance some overseas families may need a full time foreign language tutor and translator far more than they need a high rent house, and single workers in lonelier outposts may need frequent home leave more than they need a house.

Undoubtedly such a deduction would decrease revenue and increase administration costs. Arriving at the appropriate formula and reckoning the annual deduction would prove a knotty and tedious task. The workload of the IRS would clearly increase.

Annual Substantial Exclusions Set for Each Nation Each Year By Number of Dependents

Such a fine honed system of exclusions would come closest to achieving equity for Americans abroad and at home with the least loss of revenue.

It would provide incentive for export as long as an incentive were written in, and it would tend to equalize competitiveness without abrogation of the principle of taxation overseas.

In theory it would increase the number of employees sent overseas as much as the substantial general exclusion, and like it would encourage middle level postings more than high level ones. It could prove a relatively even-handed measure between all kinds and sizes of firms abroad and no matter what sort of costs prevailed in a likely market overseas.

In practice, however, this system would not succeed in causing more overseas postings for some while. It is an entirely novel system, so industries will hang fire and not be willing to act on it for the first few years. This weakness stems from the fact that no matter how comprehensive and clear and careful the formula for the exclusions might be, the annual reckoning would be up to the IRS. The IRS has the natural and laudable aim of trying to collect as much revenue as it can. In the last few years its interpretations and practices have diminished the value of the overseas deductions currently in effect.

So industry is likely to hold back from such a refined system of exclusions for a few years in order to see precisely how such a system works in practice. If and when the calibrated exclusions turn out to seem adequate and fair, then industry would increase the number of employees abroad.

In the long run this measure might be worth consideration -- if a system could be devised which provided a comprehensive formula for reckoning up the diverse exclusions, and if legislation could be written which allowed the IRS to take the just modicum of revenue but inhibited it from impingeing on the incentive or whittling away at allowances for real and justifiable costs.

If any of the exclusion-plus systems becomes law and the "plus factor" reckoned by the IRS continues to seem fair and adequate to those overseas, then perhaps they could later accept and act upon the nation by nation exclusions as a practical and reasonable alternative system.

Analogous Taxation of Americans Overseas and in the US

If at some point the US income tax regulations were to undergo a profound reorganization it might be possible to devise a system of rules which could be applied equally and equitably without decreasing American competitiveness overseas any more than the time-honored limited exclusion system does.

What would be required is a system with highly elastic, indexed "standard" deductions and a far greater number of itemized deductions than now exist, such as: 1. cost of living by state as well as by nation; 2. very flexible deductions for occupationally induced expenses such as house moving; 3. special deductions for those with language problems; 4. automatic deductibility of any and all other taxes paid, and so on down the list.

Properly devised such a scheme would allow analgous taxation of Americans abroad with Americans at home and perhaps prove more equitable for Americans at home as well.

Clearly it is not an immediate alternative, but it is a faint possibility which could be kept in mind the next time income tax undergoes a ground-shakingly thorough revision.

Which Measure Should Be Adopted Now?

If over the next decades wholesale changes become feasible, such as: 1. a worlwide convention on overseas tax, or 2. diverse exclusions for each nation each year, or 3. a profoundly reorganized US tax system, then their adoption might improve equity and competitiveness alike. For the present, they are impractical.

The US export problem exists now, and US industry reports it needs a better taxation system now if it is to increase efforts abroad. The 1978 attempt to improve the 1976 system did not increase postings overseas; it continued to discourage them.

If overseas taxation is to be modified now, either the total exclusion or the substantial exclusion-plus are the methods of choice. Both systems will tend to equalize competition with foreign rivals by cutting costs. Both systems will increase the size of the American labor force overseas in the short run, and in the long run increase the number of Americans in the resident labor force with export expertize, and thus increase America's capacity to initiate further export efforts abroad. Both systems are clear cut and durable enough so that companies will know where they stand and what to expect over the years to come. They are systems that industry itself has requested and systems that industry says it will act upon.

The total exclusion will have the most dramatic effect in increasing the overseas labor force immediately and will come nearest to equalizing US competitiveness abroad. But it will have the greatest long run effect only if Congress lets it stand for several years to see how well it works, and if Congress remains willing to consider furthere legislation for overseas firms and wider recognition of the status of individuals overseas despite the fact that they pay no income tax.

The substantial exclusion-plus system is preferable if there is any doubt as to how long the total exclusion will be allowed to prevail, or if there is any disposition to favor moderate sized industries' export efforts rather than the efforts of the richest firms. It is preferrable if it is only on condition that Americans overseas pay income tax that Congress will consider other improvements in the services and status they have. The total number of workers sent overseas immediately, and the number of uni-nationals starting up export for the first time may be smaller, but the long run productivity of each employee and each branch may be greater if they enjoy further practical legislative change rather than the extra tax dollars they will continue to pay.

Bibliography

The British Sources

American Chamber of Commerce (UK). Anglo-American Trade Directory. May not be readily available, but was only used as an indicator of Anglo-American commercial connections as of 1978.

Department of Employment. Gazette. "Work Permit Statistics". May 1974 for 1973. Pages 408-411. Also describes changes in regulations on permit issuances and change in the way the data is published.
April 1975 for 1974. Pages 318-321
May 1976 for 1975. Pages 478-481.
May 1977 for 1976. Pages 478-481.
April 1978 for 1977. Pages 429-433.
June 1979 for 1978. Pages 553-557.
September 1979 for Jan-June 1979. Pages 881-2.
Note: Full 1979 data not yet published. It will not appear in the April issue for 1980, which will not be published until July. The Gazette normally appears some months later than its stated date.

The Government Statistical Service. Central Statistical Office. Annual Abstract of Statistics. 1979 or earlier years.

The Governnment Statistical Service. Office of Population Censuses and Surveys. International Migration. Any recent year will do; each repeats information from the 1971 Census.

The Home Office. Control of Immigration Statistics. This statistical pamphlet is bound into the Parliamentary Papers for each year and can be found by checking their index, and by its Command Number.
1973 is Command Number 5603
1974 is Command Number 6064
1975 is Command Number 6504
1976 is Command Number 6883
1977 is Command Number 7160
1978 is Command Number 7565. It was issued April 1980 and will not yet be bound in Parliamentary Papers. Note: There are no errata in the arrival data used. The low 1052 arrivals of permit holders for 1975 is not a misprint. It was specifically checked twice with different Home Office officials.

The London Times. The Times' Top 1,000 1977-78. Indication of firms being American has to be extracted from the Tables. Information on firms making a loss is in the text.

US Sources

Department of Commerce. Monthly Labor Review. Provides quarterly international cost of living index. January 1979 warns tax change alters remuneration abroad.

Department of State Consular Service, Passport Service. The Quarterly Summary of Passport Statistics has an "Annual Supplement for the Year ....", which is quicker to use and more complete. Data pre-1973 is too erratic to use, as explained in the introductory matter for 1972 and 1973.

Department of State "US Citizens Residing in Foreign Countries". An annual 2 or 3 page estimate. Not listed in bibliographiesavailable in the UK. Not available even at the US Embassy in London or through a helpful consul; perhaps more easily available in the US. (A copy of 1979 was obtained by sheer luck.)

US Immigration Service. The Annual Report 1973-1977. Print is exceedingly small; a magnifying glass will be needed.

Internal Revenue Service. Statistics of Income for 1975. Index heading "foreign tax credits" leads directly to all the relevant information.

Internal Revenue Service. "Tax Guide for US Citizens Abroad". 1979 Edition.

New York Times' Index. Use heading "US" for its coverage of overseas tax.

Readers' Guide to Periodical Literature. 1973-80. Use heading "Americans Abroad" for the widespread coverage of this story.

US Statistical Abstract. 1973-1979.

TESTIMONY IN SUPPORT OF TAX RELIEF FOR AMERICAN OVERSEAS TAXPAYERS

(Prepared for the Subcommittee on Taxation and Debt Management of the Committee on Finance of the United States Senate.)

My name is I. Henry Fredricks. I am an independent tax consultant and editor and publisher of THE OVERSEAS TAXSAVER, a monthly newsletter on U.S. taxes with subscribers in more than 50 countries. I am currently chairman of the Independent American Business Committee of the American Chamber of Commerce in Hong Kong. I have lived abroad since 1959 and have prepared thousands of tax returns for Americans living abroad.

I must confess that I have been bewildered as I have watched our Government consistently follow a policy of hampering its businessmen abroad. While that may not be a deliberate policy, it has been just as effective in stifling American trade as if it had been planned. The steadily increasing trade deficits bear mute testimony to its effectiveness.

The aspect of our policy which I wish to discuss today is, of course, the taxation of Americans abroad. Although I am a tax practitioner and the recent changes in the tax law have benefited my business, I am philosophically opposed to the taxation of foreign earnings and believe that it should be abolished.

Americans working abroad have different problems than their peers. In addition to paying taxes in their country of residence, they must also pay taxes to their home country. This increased tax burden must either be borne by the employer or by the individual. If borne by the employer, the cost must affect the employer's competitiveness. If borne by the individual, then he is placed in the position of having less disposable income for day to day living and/or retirement planning.

, Wah Yuen Building, 149 Queen's Road, Central, Hong Kong Tel. 5-445584, 5-445812 Cables: FREDRICKS, Hong Kong Telex: 83198 OXWIN HX

Since most American based multinational corporations must compensate their American personnel for the increased tax burden resulting from over-seas employment, they are hiring more and more non-Americans to fill jobs which were formerly filled by Americans. They must do so in order to remain cost competitive with their international competitors whose expatriate employees are not taxed by their home country.

The problems of those expatriate Americans working for multinational employers and the resulting problems faced by the American employers of such workers has already been well documented in presentations made to this committee. The actions of our own government make the employment of Americans abroad a luxury which fewer employers--including American based multinationals--can continue to afford. I would like to cite the specific example of one company's experience.

In the June, 1979, issue of THE OVERSEAS TAXSAVER, I wrote the following:

> "This spring, Duty Free Shoppers, Ltd., a Hong Kong based multi-national company, was hiring five new executives in the $50,000 per year bracket. In the past, the company has always recruited Americans. However, the onerous burden the new tax places on employers who make their employees whole on tax costs caused the company to recruit in Europe. Had the old Sec. 911 exclusion of $20,000/25,000 remained in effect, these jobs would have been filled with Americans and IRS would have collected some taxes, surplus earnings would have been deposited and invested in the U.S., and the executives would have been predisposed to buy American made goods and services. The five Europeans will pay no taxes to their home country or to the U.S. and it is highly unlikely that their savings and investments will flow to the U.S. In addition, they will be predisposed to buy European products. Is that the result that Congress was seeking when it passed the Foreign Earned Income Act of 1978? I doubt it."

Five executives were hired. None were Americans. They do not pay taxes to either their home country or the U.S. They do not put their savings in the U.S. and their buying trips are to London rather than to New York and Los Angeles. The company recently recruited assistants for some of those executives. No, they did not recruit in New York. Once again they recruited in England. After all, if they hired American assistants they would have to pay them more than they pay the senior executives!

Those expatriate Americans who work for employers under a tax equalization umbrella receive the same compensation they would have received in Peoria or Wetumka. There are, however, thousands of other overseas Americans who are not under a tax equalization umbrella and the increased burden of overseas taxation falls directly on them.

I think the best way to illustrate the problems faced by the independent Americans outside the corporate umbrella is to look at an actual return of one of them. I am attaching to this paper a copy of an actual tax return that I did for an American secretary who is working for a non-U.S. employer and is not under tax equalization protection. She has only two items of income: a $16,851 salary and interest from a bank in Ohio in the amount of $930. In the United States, she would have filed a simple three-page return. Because she works abroad, she must file a ten-page return plus a Treasury Form 90-22.1 Report of Foreign Bank Account. The average overseas return is more than fifteen pages and a twenty-five page return is common.

The only contact most Americans abroad have with the United States government is through the Internal Revenue Service. Each year they are traumatized by the receipt of a Manila envelope bearing a computer printed label with their name, social security number, and address. It contains the same standard 1040 package which stateside taxpayers receive plus special forms and instructions for overseas filers. This year, Form 2555 consisted of four pages plus eight pages of instructions; Form 1116 was two pages long with two pages of instructions. Then there was the additional forty-five pages of Publication 54. The entire package weighed fourteen ounces and was mailed to overseas taxpayers via air mail. A complete package is included herewith so that the committee can fully appreciate the complexity of an overseas tax return.

This committee is already aware of the importance of large American corporations abroad and I am sure you are aware of how important it is that they continue to be staffed by Americans whenever possible. But the role of independent Americans abroad is equally important. American school teachers play an important role in influencing future events.

American insurance salesmen, real estate salesmen, investment brokers, and manufacturers' representatives all sell American products and are responsible for the inflow of millions of dollars into the United States each year. All of us buy American products for our own use because we are familiar with them. Most of us concentrate our investments in the United States and maintain the bulk of our savings in United States banks. Most of us will ultimately retire in the United States. We live and work with expatriates from other countries who do the same things with respect to their home countries. The big difference is that the governments of other countries tell their citizens to go out and make money and come home to spend it. Ours is the only one that tells its citizens to go out and make it and send it back for the Government to spend.

In conclusion, I suggest that this Congress put me out of business by abolishing the tax on foreign earnings of Americans living abroad. All Americans would benefit because Americans overseas could then concentrate on expanding American exports to create more American jobs instead of worrying about facing an ever growing tax burden.

This is a year of decision. Thousands of Americans abroad have been hoping for relief from the taxation of their foreign earnings. Their patience is wearing then and many more deciding that if no relief comes this year, they will be returning to the U.S. to compete in the job market there or, perhaps, to swell the welfare rolls. Multinational employers are facing the decision of whether to continue to absorb the ever higher cost of maintaining American workers abroad or to replace them with other expatriates whose home government doesn't tax their foreign earnings. And, finally, this Congress must make the conscious decision that it is either going to encourage the sales of American goods and services abroad by eliminating an unfair tax burden on overseas earnings or that it is going to participate in the conspiracy to hamper such sales by continuing in effect laws which limit our competitiveness.

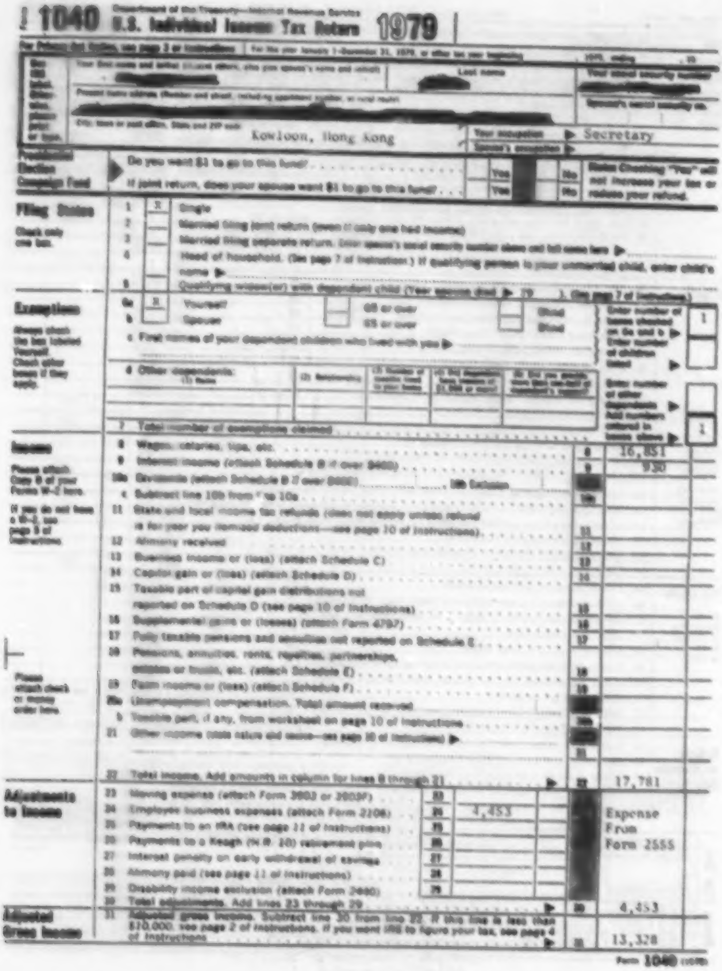
The decision is yours.

Respectfully submitted,

I. H. Fredricks

I. H. Fredricks

IHF/sl



Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return **1979**

For Privacy Act Notice, see page 3 of Instructions | For the year January 1–December 31, 1979, or other tax year beginning , 1979, ending , 19

Use IRS label. Otherwise, please print or type.

Your first name and initial (if joint return, also give spouse's name and initial): [redacted]
Last name: [redacted]
Your social security number: [redacted]
Present home address (Number and street, including apartment number, or rural route): [redacted]
Spouse's social security no.:
City, town or post office, State and ZIP code: Kowloon, Hong Kong
Your occupation ▶ Secretary
Spouse's occupation ▶

Presidential Election Campaign Fund ▶ Do you want $1 to go to this fund? ☐ Yes ☐ No
If joint return, does your spouse want $1 to go to this fund? ☐ Yes ☐ No
Note: Checking "Yes" will not increase your tax or reduce your refund.

Filing Status
Check only one box.
1 ☒ Single
2 ☐ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security number above and full name here ▶
4 ☐ Head of household. (See page 7 of Instructions.) If qualifying person is your unmarried child, enter child's name ▶
5 ☐ Qualifying widow(er) with dependent child (Year spouse died ▶ 19). (See page 7 of Instructions.)

Exemptions
Always check the box labeled Yourself. Check other boxes if they apply.
6a ☒ Yourself ☐ 65 or over ☐ Blind
b ☐ Spouse ☐ 65 or over ☐ Blind
Enter number of boxes checked on 6a and b ▶ 1
c First names of your dependent children who lived with you ▶
Enter number of children listed ▶

d Other dependents: (1) Name	(2) Relationship	(3) Number of months lived in your home	(4) Did dependent have income of $1,000 or more?	(5) Did you provide more than one-half of dependent's support?

Enter number of other dependents ▶
7 Total number of exemptions claimed
Add numbers entered in boxes above ▶ 1

Income
Please attach Copy B of your Forms W-2 here.
If you do not have a W-2, see page 5 of Instructions.
Please attach check or money order here.

8	Wages, salaries, tips, etc.	8	16,851
9	Interest income (attach Schedule B if over $400)	9	930
10a	Dividends (attach Schedule B if over $400) ..... 10b Exclusion		
c	Subtract line 10b from line 10a	10c	
11	State and local income tax refunds (does not apply unless refund is for year you itemized deductions—see page 10 of Instructions)	11	
12	Alimony received	12	
13	Business income or (loss) (attach Schedule C)	13	
14	Capital gain or (loss) (attach Schedule D)	14	
15	Taxable part of capital gain distributions not reported on Schedule D (see page 10 of Instructions)	15	
16	Supplemental gains or (losses) (attach Form 4797)	16	
17	Fully taxable pensions and annuities not reported on Schedule E	17	
18	Pensions, annuities, rents, royalties, partnerships, estates or trusts, etc. (attach Schedule E)	18	
19	Farm income or (loss) (attach Schedule F)	19	
20a	Unemployment compensation. Total amount received		
b	Taxable part, if any, from worksheet on page 10 of Instructions	20b	
21	Other income (state nature and source—see page 10 of Instructions) ▶	21	
22	Total income. Add amounts in column for lines 8 through 21 ▶	22	17,781

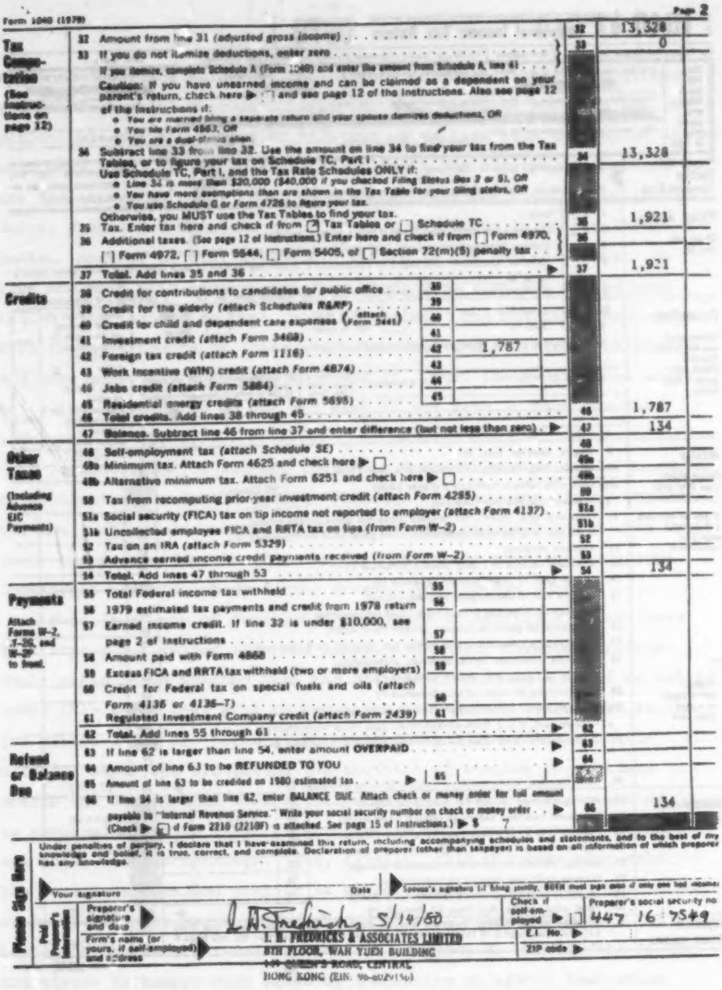
Adjustments to Income

23	Moving expense (attach Form 3903 or 3903F)	23			
24	Employee business expenses (attach Form 2106)	24	4,453		Expense From Form 2555
25	Payments to an IRA (see page 11 of Instructions)	25			
26	Payments to a Keogh (H.R. 10) retirement plan	26			
27	Interest penalty on early withdrawal of savings	27			
28	Alimony paid (see page 11 of Instructions)	28			
29	Disability income exclusion (attach Form 2440)	29			
30	Total adjustments. Add lines 23 through 29 ▶	30			4,453

Adjusted Gross Income

31	Adjusted gross income. Subtract line 30 from line 22. If this line is less than $10,000, see page 2 of Instructions. If you want IRS to figure your tax, see page 4 of Instructions ▶	31	13,328

Form **1040** (1979)



Form 1040 (1979) Page 2

Tax Computation (See Instructions on page 12)	32	Amount from line 31 (adjusted gross income)			32	13,328
	33	If you do not itemize deductions, enter zero If you itemize, complete Schedule A (Form 1040) and enter the amount from Schedule A, line 41			33	0
		Caution: If you have unearned income and can be claimed as a dependent on your parent's return, check here ▶ ☐ and see page 12 of the Instructions. Also see page 12 of the Instructions if: • *You are married filing a separate return and your spouse itemizes deductions, OR* • *You file Form 4563, OR* • *You are a dual-status alien.*				
	34	Subtract line 33 from line 32. Use the amount on line 34 to find your tax from the Tax Tables, or to figure your tax on Schedule TC, Part I			34	13,328
		Use Schedule TC, Part I, and the Tax Rate Schedules ONLY if: • *Line 34 is more than $20,000 ($40,000 if you checked Filing Status Box 2 or 5), OR* • *You have more exemptions than are shown in the Tax Table for your filing status, OR* • *You use Schedule G or Form 4726 to figure your tax.* Otherwise, you MUST use the Tax Tables to find your tax.				
	35	Tax. Enter tax here and check if from ☒ Tax Tables or ☐ Schedule TC			35	1,921
	36	Additional taxes. (See page 12 of Instructions.) Enter here and check if from ☐ Form 4970, ☐ Form 4972, ☐ Form 5544, ☐ Form 5405, or ☐ Section 72(m)(5) penalty tax			36	
	37	**Total.** Add lines 35 and 36 ▶			37	1,921
Credits	38	Credit for contributions to candidates for public office	38			
	39	Credit for the elderly *(attach Schedules R&RP)*	39			
	40	Credit for child and dependent care expenses (attach Form 2441)	40			
	41	Investment credit *(attach Form 3468)*	41			
	42	Foreign tax credit *(attach Form 1116)*	42	1,787		
	43	Work Incentive (WIN) credit *(attach Form 4874)*	43			
	44	Jobs credit *(attach Form 5884)*	44			
	45	Residential energy credits *(attach Form 5695)*	45			
	46	**Total credits.** Add lines 38 through 45			46	1,787
	47	**Balance.** Subtract line 46 from line 37 and enter difference (but not less than zero) ▶			47	134
Other Taxes (Including Advance EIC Payments)	48	Self-employment tax *(attach Schedule SE)*			48	
	49a	Minimum tax. Attach Form 4625 and check here ▶ ☐			49a	
	49b	Alternative minimum tax. Attach Form 6251 and check here ▶ ☐			49b	
	50	Tax from recomputing prior-year investment credit *(attach Form 4255)*			50	
	51a	Social security (FICA) tax on tip income not reported to employer *(attach Form 4137)*			51a	
	51b	Uncollected employee FICA and RRTA tax on tips *(from Form W-2)*			51b	
	52	Tax on an IRA *(attach Form 5329)*			52	
	53	Advance earned income credit payments received *(from Form W-2)*			53	
	54	**Total.** Add lines 47 through 53 ▶			54	134
Payments Attach Forms W-2, W-2G, and W-2P to front.	55	Total Federal income tax withheld	55			
	56	1979 estimated tax payments and credit from 1978 return	56			
	57	Earned income credit. If line 32 is under $10,000, see page 2 of Instructions	57			
	58	Amount paid with Form 4868	58			
	59	Excess FICA and RRTA tax withheld (two or more employers)	59			
	60	Credit for Federal tax on special fuels and oils *(attach Form 4136 or 4136–T)*	60			
	61	Regulated Investment Company credit *(attach Form 2439)*	61			
	62	**Total.** Add lines 55 through 61 ▶			62	
Refund or Balance Due	63	If line 62 is larger than line 54, enter amount **OVERPAID** ▶			63	
	64	Amount of line 63 to be **REFUNDED TO YOU** ▶			64	
	65	Amount of line 63 to be credited on 1980 estimated tax ▶	65			
	66	If line 54 is larger than line 62, enter **BALANCE DUE**. Attach check or money order for full amount payable to "Internal Revenue Service." Write your social security number on check or money order ▶ (Check ▶ ☐ if Form 2210 (2210F) is attached. See page 15 of Instructions.) ▶ $ 7			66	134

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Your signature Date

▶ Spouse's signature (if filing jointly, BOTH must sign even if only one had income)

Paid Preparer's Information	Preparer's signature and date ▶ I. H. Fredricks 5/14/80	Check if self-employed ▶ ☐	Preparer's social security no. 447 16 7549
	Firm's name (or yours, if self-employed) and address ▶ I. H. FREDRICKS & ASSOCIATES LIMITED 8TH FLOOR, WAH YUEN BUILDING 149 QUEEN'S ROAD, CENTRAL HONG KONG (EIN: 98-0029156)	E.I. No. ▶	
		ZIP code ▶	

Schedules A&B (Form 1040) 1979

Schedule B—Interest and Dividend Income

Page 2

Name(s) as shown on Form 1040 (Do not enter name and social security number if shown on other side)

[redacted]

Your social security number

[redacted]

Part I Interest Income

1 If you received more than $400 in interest, complete Part I and Part III. Please see page 9 of the instructions to find out what interest to report. Then answer the questions in Part III, below. If you received interest as a nominee for another, or you received or paid accrued interest on securities transferred between interest payment dates, please see page 18 of the instructions.

Name of payer	Amount
[redacted]	930
2 Total interest income. Enter here and on Form 1040, line 9	930

Part II Dividend Income

3 If you received more than $400 in gross dividends (including capital gain distributions) and other distributions on stock, complete Part II and Part III. Please see page 9 of the instructions. Write (H), (W), or (J), for stock held by husband, wife, or jointly. Then answer the questions in Part III, below. If you received dividends as a nominee for another, please see page 19 of the instructions.

Name of payer	Amount

4 Total of line 3 . . . .

5 Capital gain distributions. Enter here and on the appropriate line(s) on Schedule D. See Note below . . . .

6 Nontaxable distributions . . . .

7 Total (add lines 5 and 6) . . . .

8 Dividends before exclusion (subtract line 7 from line 4). Enter here and on Form 1040, line 10a . . . .

Note: *If your capital gain distributions for the year do not include any gains before Nov. 1, 1978, and you do not need Schedule D to report any gains or losses, do not file that schedule. Instead, enter the taxable part of your capital gain distributions on Form 1040, line 15.*

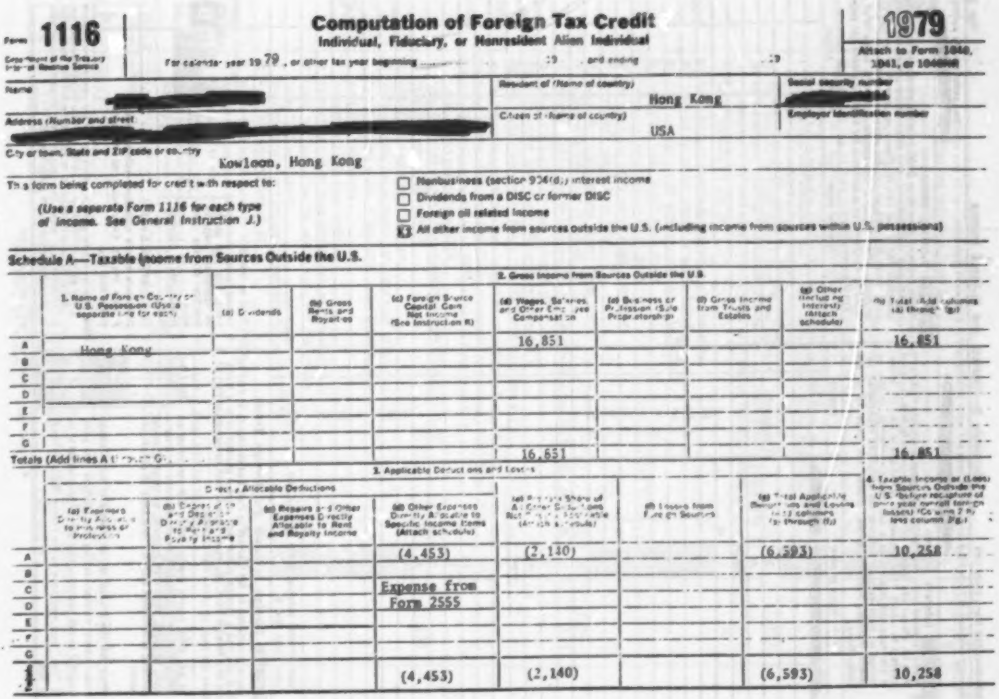
B

Part III Foreign Accounts and Foreign Trusts

If you are required to list interest in Part I or dividends in Part II, OR if you had a foreign account or were a grantor of or a transferor to a foreign trust, you must answer both questions in Part III. Please see page 19 of the instructions.

	Yes	No
A At any time during the tax year, did you have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country (see page 19 of instructions)?	X	
B Were you the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not you have any beneficial interest in it? If "Yes," you may have to file Forms 3520, 3520-A, or 926.		X

U.S. GOVERNMENT PRINTING OFFICE 1979 O 283 001 22 217-0883



Form **1116**

Department of the Treasury
Internal Revenue Service

Computation of Foreign Tax Credit

Individual, Fiduciary, or Nonresident Alien Individual

For calendar year 19 79 , or other tax year beginning .... 19 , and ending 19

1979

Attach to Form 1040, 1041, or 1040NR

Name [redacted]	Resident of (Name of country) Hong Kong	Social security number [redacted]
Address (Number and street) [redacted]	Citizen of (Name of country) USA	Employer identification number

City or town, State and ZIP code or country Kowloon, Hong Kong

This form being completed for credit with respect to:

(Use a separate Form 1116 for each type of income. See General Instruction J.)

- ☐ Nonbusiness (section 904(d)) interest income
- ☐ Dividends from a DISC or former DISC
- ☐ Foreign oil related income
- ☒ All other income from sources outside the U.S. (including income from sources within U.S. possessions)

Schedule A—Taxable Income from Sources Outside the U.S.

	1. Name of Foreign Country or U.S. Possession (Use a separate line for each)	2. Gross Income from Sources Outside the U.S.							
		(a) Dividends	(b) Gross Rents and Royalties	(c) Foreign Source Capital Gain Net Income (See Instruction K)	(d) Wages, Salaries, and Other Employee Compensation	(e) Business or Profession (Sole Proprietorship)	(f) Gross Income from Trusts and Estates	(g) Other (including interest) (Attach schedule)	(h) Total (Add columns (a) through (g))
A	Hong Kong				16,851				16,851
B									
C									
D									
E									
F									
G									
Totals (Add lines A through G)					16,851				16,851

	3. Applicable Deductions and Losses							4. Taxable Income or (Loss) from Sources Outside the U.S. (before recapture of prior year overall foreign losses) (Column 2(h) less column 3(g))
	Directly Allocable Deductions							
	(a) Expenses Directly Allocable to Business or Profession	(b) Depreciation and Depletion Directly Allocable to Rent and Royalty Income	(c) Repairs and Other Expenses Directly Allocable to Rent and Royalty Income	(d) Other Expenses Directly Allocable to Specific Income Items (Attach schedule)	(e) Pro rata Share of All Other Deductions Not Directly Allocable (Attach schedule)	(f) Losses from Foreign Sources	(g) Total Applicable Deductions and Losses (Add columns (a) through (f))	
A				(4,453)	(2,140)		(6,593)	10,258
B								
C				Expense from				
D				Form 2555				
E								
F								
G								
Totals				(4,453)	(2,140)		(6,593)	10,258

Schedule B—Foreign Taxes Paid or Accrued

	1. Credit is claimed for taxes ☒ Paid	☐ Accrued	2. Type of Tax	3. Statute Imposing Tax (Title, number, section, etc.) (Identify in detail)	4. Foreign Taxes Paid or Accrued (Attach receipt or copy of return) (See General Instruction M) In Foreign Currency Tax Withheld at Source on:				In U.S. Dollars (See instructions for Schedule B, column 4) Tax Withheld at Source on:				5. Reduction for Taxes on Income Excluded under Section 911, Foreign Mineral Income and for Failure to Furnish Returns Required under Section 6038 (Also See General Instruction N)
	Date Paid	Date Accrued			(a) Dividends	(b) Rents and Royalties	(c) Other Foreign Taxes Paid or Accrued	(d) Conversion Rate (Attach schedule)	(e) Dividends	(f) Rents and Royalties	(g) Other Foreign Taxes Paid or Accrued	(h) Total Foreign Taxes Paid or Accrued (Add cols. (e), (f), and (g))	
A	Carryover												
B													
C													
D													
E													
F													
G													
Totals (Add lines A through G)													

Schedule C—Computation of Foreign Tax Credit

1 Total foreign taxes paid or accrued (from Schedule B, column 4(h), "Totals" line)	.1977 .1978	1			
2 Carryback or carryover (attach detailed computation) (see General Instruction L)	2,301 1,976	2	4,277		
3 Reduction for taxes (from Schedule B, column 5, "Totals" line)		3			
4 Total foreign taxes available for credit (Add lines 1 and 2, and subtract line 3 from the result)				4	4,277
5 Taxable income or (loss) from sources outside the U.S. (from Schedule A, column 4, "Totals" line). (If loss, skip lines 6 through 16)		5	10,258		
6 Recapture of prior year overall foreign losses (see General Instruction K)		6			
7 Net foreign source taxable income (Subtract line 6 from line 5)				7	10,258
8 Individuals: Enter amount from Form 1040, line 34, or Form 1040NR, line 39. Estates and trusts: Make no entry, skip to line 10		8	13,328		
9 Enter $3,400 (joint return or widow(er)), $2,300 (single or head of household), or $1,700 (married filing separate return)		9	2,300		
10 Individuals: Subtract line 9 from line 8.—Estates and trusts: Enter on this line your taxable income without the deduction for your exemption				10	11,028
11 Divide line 7 by line 10. (If line 7 is more than line 10, enter the figure "1.")				11	.9302
12 Total U.S. income tax before any credits (see General Instruction D)		12	1,921		
13 Credit for the elderly	13				
14 Subtract line 13 from line 12				14	1,921
15 Limitation on credit (Multiply line 14 by line 11)				15	1,787
16 Foreign tax credit (line 4 or line 15, whichever is smaller)				16	1,787

Schedule D—Summary of Credits from Separate Schedules C

1 Credit with respect to nonbusiness (section 904(d)) interest	1			
2 Credit with respect to dividends from a DISC or former DISC	2			
3 Credit with respect to foreign oil related income	3			
4 Credit with respect to all other income from sources outside the U.S. (including income from sources within U.S. possessions)	4	1,787		
5 Total (Add lines 1 through 4)			5	1,787
6 Reduction in credit for international boycott operations (see General Instruction N)			6	
7 Foreign tax credit (Subtract line 6 from line 5). Enter here and on your tax return			7	1,787

Schedule - Form 1116 - 1979

INCOME		U.S.	FOREIGN	TOTAL
Total earned income			16,851	16,851
Interest (Form 1040, line 9)		930		930
Adjustments (Form 1040, line 30)			(4,453)	(4,453)
		930	12,398	13,328
DEDUCTIONS PRORATED				
$\frac{2,300 \times 930}{13,328}$	=	(160)		(160)
$\frac{2,300 \times 12,398}{13,328}$	=		(2,140)	(2,140)
Taxable income (before Personal Exemptiosn)		770	10,258	11,028

Form **2210**
Department of the Treasury
Internal Revenue Service

Underpayment of Estimated Tax by Individuals

▶ Attach to Form 1040. ▶ See instructions on back.

1979

Name(s) as shown on Form 1040: [redacted]

Social security number: [redacted]

Part I How to Figure Your Underpayment (Complete lines 1 through 17)

If you meet any of the exceptions to the underpayment penalty for ALL four periods, skip lines 1 through 17 and go directly to line 18.

1 1979 tax (from Form 1040, line 54)		134
2 Earned income credit (from Form 1040, line 57)		
3 Tax credit for special fuels and oils (from Form 1040, line 60)		
4 Minimum tax (from Form 1040, line 49a)		
5 Alternative minimum tax (from Form 1040, line 49b)		
6 Social security (FICA) tax on unreported tip income (from Form 1040, line 51a)		
7 Uncollected employee FICA and RRTA tax on tips (from Form 1040, line 51b)		
8 Tax on an IRA (from Form 5329, Part I or III included on Form 1040, line 52)		
9 Refundable business energy credit (from Schedule B (Form 3468) included on Form 1040, line 62)		
10 Total (add lines 2 through 9)		
11 Balance (subtract line 10 from line 1)		134
12 Enter 80% of the amount shown on line 11		107.20

	Payment Due Dates			
	(a) Apr. 15, 1979	(b) June 15, 1979	(c) Sept. 15, 1979	(d) Jan. 15, 1980
13 Divide amount on line 12 by the number of payments required for the year. Enter the result in appropriate columns	26.80	26.80	26.80	26.80
14 Amounts paid on estimated tax and tax withheld				
15 Overpayment (on line 17) from previous period				
16 Total (add lines 14 and 15)				
17 Underpayment (subtract line 16 from line 13) OR Overpayment (subtract line 13 from line 16)	26.80	26.80	26.80	26.80

Part II Exceptions to the Penalty (Farmers and fishermen, see Instruction A for special exception)

18 Total amount paid and withheld from January 1 through the payment due date shown				
	25% of 1978 tax	50% of 1978 tax	75% of 1978 tax	100% of 1978 tax
19 Exception 1.—1978 tax ▶ $				
20 Exception 2.—Tax on 1978 income using 1979 rates and exemptions (attach computation)	Enter 25% of tax	Enter 50% of tax	Enter 75% of tax	Enter 100% of tax
21 Exception 3.—Tax on annualized 1979 income (see worksheet on back)	Enter 20% of tax	Enter 40% of tax	Enter 60% of tax	Not applicable
22 Exception 4.—Tax on 1979 income over 3, 5, and 8-month periods (attach computation)	Enter 90% of tax	Enter 90% of tax	Enter 90% of tax	

Part III How to Figure the Penalty (Complete lines 23 through 27)

23 Amount of underpayment (from line 17)	26.80	26.80	26.80	26.80
24 Date of payment	4/15/80	4/15/80	4/15/80	4/15/80
25 (a) Number of days after due date of payment to and including date of payment or January 31, 1980, whichever is earlier	291	230	138	16
(b) Number of days from and including February 1, 1980, to and including date of payment or April 15, 1980, whichever is earlier	75	75	75	75
26 (a) 6 percent a year on the amount shown on line 23 for the number of days shown on line 25(a)	1	1	1	0
(b) 12 percent a year on the amount shown on line 23 for the number of days shown on line 25(b)	1	1	1	1
27 Penalty (add amounts on lines 26(a) and (b)). Check the box below line 66 on Form 1040 and show this amount in the space provided. If you owe tax on line 66, include the penalty amount in with your total payment. If you are due a refund, we will subtract the penalty amount from the amount on line 63				7

Form **2555**
Department of the Treasury
Internal Revenue Service

Deduction from, or Exclusion of, Income Earned Abroad

▶ See separate instructions. ▶ Attach to Form 1040.
For the year January 1–December 31, 1979, or other tax year beginning ...., 1979, ending ...., 19....

1979
31

This Form is to be Used Only by United States Citizens and Resident Aliens

Name of taxpayer [redacted]
Social security number [redacted]

Foreign address (including Country) [redacted] Kowloon, Hong Kong
Your occupation Secretary

Name of employer ▶ [redacted]

Employer's address	U.S. ▶	None
	Foreign ▶	[redacted]

Employer is (check any that apply) ☐ A foreign entity ☒ A U.S. company ☐ A foreign affiliate of a U.S. company ☐ Self ☐ Other (specify) ▶

Give the latest year for which you filed a U.S. income tax return ▶ 1978 Service Center where filed ▶ Philadelphia

Enter earlier years you claimed deduction from, or exclusion of, income earned abroad under section 911 or 913 ▶

Check the status under which you claim deduction from, or exclusion of, income earned from services abroad ☒ Bona fide residence. ☐ Physical presence.
Are you a U.S. citizen? ☒ Yes ☐ No

Complete all items in either Part I or Part II. If an item does not apply, write "DOES NOT APPLY." Failure to submit required information may result in disallowance of the claimed deduction or exclusion.

Part I To be Completed for Bona Fide Residence Only (See Instruction 8)

1 List the countries where you have lived and the dates of residence during your 1978 and 1979 tax years
Hong Kong Both Years
.... Bona fide residence began (date) 10/1/74, ended (date) Continues

2 Kind of living quarters in foreign country ▶ ☐ Purchased house ☒ Rented house or apartment ☐ Rented room ☐ Quarters furnished by employer

3 Did any of your family live with you abroad during any part of the tax year? ☐ Yes ☒ No
If "Yes," who and for what period? ▶

4 (a) Have you made a statement to the authorities of the foreign country you claim bona fide residence in that you are not a resident of that country? ☐ Yes ☒ No

(b) Are you required to pay income tax to the country you claim bona fide residence in? ☒ Yes ☐ No
If you made a statement to the authorities of the foreign country that you are not a resident, and the country holds you are not subject to its income tax, you do not qualify for this status. (See Instruction 8(c).)

5 Complete the following for days present in the U.S. or its possessions during the tax year:

Date arrived in U.S.	Date departed from U.S.	Number of days in U.S. on business	Amount earned in U.S. on business (Attach statement showing computation.)[1]	Date arrived in U.S.	Date departed from U.S.	Number of days in U.S. on business	Amount earned in U.S. on business (Attach statement showing computation.)[1]
June 29	July 20	0					

[1] Do not include this income in Part III. Report on Form 1040.

6 (a) State any contractual terms or other conditions relating to the length of your employment abroad None

(b) State the type of visa you entered the foreign country under Employment

(c) Did your visa contain any limitations as to the length of your stay or employment in a foreign country? ☒ Yes ☐ No
If "Yes," attach explanation. Periodically Renewable

(d) Did you maintain a home in the U.S. while residing abroad? ☐ Yes ☒ No
If "Yes," show address of your home, whether it was rented, and the names and relationships of the occupants

Part II To be Completed for Physical Presence Only (See Instruction 9)

7 The 18-month period that the test of physical presence in foreign countries is based on is from .... through ....

8 Enter your principal country of employment during your tax year ▶

9 Enter all travel abroad during the 18-month period that the test is based on, except travel between foreign countries that did not involve travel on or over international waters for 24 hours or more. If the last entry is an arrival in a foreign country, enter the number of full days to the end of 18-month period. If you have no travel to report during the period, write in the schedule that you were physically present in a foreign country or countries during the entire 18-month period.

Name of country (including U.S.)	Date arrived	Date departed	Full days present in country	Number of days in U.S. on business	Amount earned in U.S. on business (Attach statement showing computation.)[1]

[1] Do not include this income in Part III. Report on Form 1040.

[illegible] To be Completed by All Taxpayers

10 Enter below all, including noncash remuneration, income from sources outside the United States earned during 1979. (See Instructions 7, 10(b), 10(c), and 10(d).) Is part of the income (such as bonuses) for services performed in 1979, but received in another tax year? . . . ☐ Yes ☒ No
If "Yes," see Instructions 10(a) and 10(e).

Report all income received during 1979 on your Form 1040 regardless of when the services were performed. *If you received all or part of your income in foreign currency, translate its exchange value into terms of U.S. dollars at the rates prevailing at the time you actually or constructively received the income. Do not report income shown in Part I, line 5, on this schedule.*

Earned Income for Personal Services Rendered in Foreign Countries During 1979	Exchange rates used	Amount (in U.S. dollars)
11 Total wages, salaries, bonuses, commissions, etc., earned this year . . .	4,985	16,851
12 Pensions and annuities (see Instruction 10(d)) . . .		
13 Allowable share of income for personal services rendered this year (see Instructions 7 and 10(a)):		
(a) In a business (including farming) or profession (attach Schedule C or F (Form 1040)) .		
(b) In a partnership (give name, address, and nature of income)		
14 Noncash remuneration (market value of property or facilities furnished by employer—attach statement showing how determined):		
(a) Home (lodging) . . .		
(b) Meals . . .		
(c) Car . . .		
(d) Other property or facilities (specify)		
15 Other foreign earned income (specify)		
16 Allowances, reimbursements, or expenses paid on your behalf for services rendered this year:		
(a) Cost of living . . .		
(b) Overseas differential . . .		
(c) Family . . .		
(d) Education . . .		
(e) Home leave . . .		
(f) Quarters . . .		
(g) For any other purpose (specify)		
(h) Total allowances, reimbursements, etc. Add lines 16(a) through line 16(g) . . .		
17 Total earned income from foreign sources (add lines 11 through 15 and line 16(h)) . . .		16,851
18 (a) Value of meals and lodging included in income above which are excludable under section 119. (See Instruction 10(c)) . . .		0
(b) Net earned income from foreign sources (subtract line 18(a) from line 17) . . . ▶		16,851

19 Did you maintain a separate foreign residence for your family due to adverse living conditions at your tax home? ☐ Yes ☒ No
If "Yes," give city and country of the separate foreign residence. Also show number of days during your tax year that you maintained a second household at that address

20 List your tax home(s) during your tax year Hong Kong
Did you change your tax home at any time during your tax year? . . . ☐ Yes ☒ No
Note: If you answered "Yes" to either 19 or 20 above, see Instructions 11, 15, and 17 before completing this form.

21 Did you live in a camp located in a hardship area for the convenience of your employer? . . . ☐ Yes ☒ No
(See Instruction 18 for a description of what is considered a camp.)
If "Yes," you may elect (a) or (b) below. If "No," you may claim (b) below.
(a) You may exclude from gross income the amount of $20,000 (prorated on a daily basis for days you lived in a camp). See Part V.
(b) You may claim the deduction for excess foreign living expenses. See Part IV.

Form 2555 (1979) Page 3

To be Completed by Taxpayers Claiming the Deduction for Excess Foreign Living Expenses

Qualified Schooling Expense (See Instruction 12)

22 Complete the following for each dependent child for whom you claim a schooling expense deduction:

Name of dependent child	Age	Address (including country) of school attended	Schooling expenses claimed

23 Total qualified schooling expenses. Enter here and on lines 31(b) and 36 . . . . ▶

Qualified Home Leave Transportation Expense (See Instruction 13)

24 Enter total number of trips for which you are claiming a deduction. Count each trip by you, your spouse, and your dependents as a separate trip ▶ . Total expense for all trips; also enter on lines 31(c) and 37 . . ▶ 1,143

Qualified Hardship Area Amount (See Instruction 14)

25 Name of hardship area .... Date tax home was established .... ended ....

26 Maximum amount . . . . $ 5,000.00

27 Number of days that you qualified during the tax year . . . .

28 Percentage applicable (divide the number of days on line 27 by 365) . . . . %

29 Allowable amount (multiply the amount on line 26 by the percent on line 28). Also enter on lines 31(d) and 38 . . . . . . ▶ $

Qualified Housing Expenses (See Instruction 16)

30 Expenses paid or incurred for housing at your tax home during the year. (If you maintained a qualified second household, see instruction 17 for additional information) 4,876

31 Figure your base housing amount as follows. Enter:

(a) Earned income from all sources (see instruction 18)		16,851	
(b) Qualified schooling expenses (from line 23)			
(c) Qualified home leave transportation expenses (from line 24) . . .	1,143		
(d) Qualified hardship area amount (from line 29)			
(e) Qualified cost-of-living differential (from tables—see instruction 15)	500		
(f) Housing expenses from line 30	4,876		
(g) Total expenses (add lines 31(b) through 31(f))		6,519	
(h) Subtract line 31(g) from line 31(a)		10,332	
(i) Base housing amount: Enter 20% (⅕) of line 31(h)			2,066
32 Subtract line 31(i) from line 30. If less than zero, enter zero			2,810
33 If you maintained a qualified second household, enter earned income as modified by instruction 17(b)(i). Otherwise, omit line 33 and enter zero on line 34(e)			
34 Amount from line 31(g)			
(a) Housing expenses for qualified second household			
(b) Add line 34 and line 34(a)			
(c) Subtract line 34(b) from line 33. If less than zero, enter zero			
(d) Base housing amount for second household; enter 20% (⅕) of line 34(c)			
(e) Subtract line 34(d) from line 34(a)			0

35 Total qualified housing expenses. If you maintained a qualified second household and your tax home was in a hardship area, enter total of amounts on lines 30 and 34(e). Otherwise, enter the total of lines 32 and 34(e). Also enter on line 40 . . . . ▶ 2,810

Summary of Excess Foreign Living Expenses

36 Qualified schooling expenses from line 23			
37 Qualified home leave transportation expenses from line 24			1,143
38 Qualified hardship area amount from line 29			
39 Qualified cost-of-living differential from line 31(e)			500
40 Qualified housing expenses from line 35			2,810
41 Total expenses (add lines 36 through 40)			4,453
42 Limitation:			
(a) Total earned income from foreign sources (from Part III, line 18(b))		16,851	
(b) Adjustments allocable to income from foreign sources (see instruction 11(b))			
(c) Net earned income from foreign sources (subtract line 42(b) from line 42(a)). If less than zero, enter zero		16,851	
43 Deduction for excess foreign living expenses. Enter the amount from line 41 or 42(c), whichever is smaller. Also enter this amount on Form 1040, line 24, and label it as "Expense from Form 2555" . . . . ▶			4,453

Form Approved
OMB No. 48-R[illegible]

Department of the Treasury
Form 90-22.1 (9 78)
SUPERSEDES ALL PREVIOUS EDITIONS

REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS

For the calendar year 19 79

OFFICIAL USE ONLY

This form should be used to report financial interest in or signature authority or other authority over one or more bank accounts, securities accounts or other financial accounts in foreign countries as required by Department of the Treasury Regulations (31 CFR 103). You are not required to file a report if the aggregate value of the accounts did not exceed $1,000. Check all appropriate boxes. SEE INSTRUCTIONS ON BACK FOR DEFINITIONS.

1 Name (Last, First, Middle)
[redacted]

2 Social security number or employer identification number if other than individual
[redacted]

3 Name in item 1 refers to
☒ Individual
☐ Partnership
☐ Corporation
☐ Fiduciary

4 Address (Street, City, State, Country, ZIP)
[redacted]

5 ☐ I had signature authority or other authority over one or more foreign accounts, but I had no "financial interest" in such accounts (see instruction J). Indicate for these accounts

(a) Name and social security number or taxpayer identification number of each owner

(b) Address of each owner

(Do not complete item 9 for these accounts)

6 ☐ I had a "financial interest" in one or more foreign accounts owned by a domestic corporation, partnership or trust which is required to file Form 90-22.1. (See instruction L). Indicate for these accounts

(a) Name and taxpayer identification number of each such corporation, partnership or trust

(b) Address of each such corporation, partnership or trust

(Do not complete item 9 for these accounts)

7 ☒ I had a "financial interest" in one or more foreign accounts, but the total maximum value of these accounts (see instruction I) did not exceed $10,000 at any time during the year. (If you checked this box, do not complete item 9)

8 ☐ I had a "financial interest" in 25 or more foreign accounts. (If you checked this box, do not complete item 9.)

9 If you had a "financial interest" in one or more but fewer than 25 foreign accounts which are required to be reported, and the total maximum value of the accounts exceeded $10,000 during the year (see instruction I), write the total number of those accounts here ☐
Complete items (a) through (f) below for one of the accounts and attach a separate Form 90-22.1 for each of the others. (Items 1, 2, 3, 9, and 10 must be completed for each account. Check here if this is an attachment ☐)

(a) Name in which account is maintained

(b) Name of bank or other person with whom account is maintained

(c) Number and other account designation, if any

(d) Address of office or branch where account is maintained

(e) Type of account. (If not certain of English name for the type of account, give the foreign language name and describe the nature of the account. Attach additional sheets if necessary.)
☐ Bank Account ☐ Securities Account ☐ Other (specify)

(f) Maximum value of account (see instruction I)
☐ Under $10,000 ☐ $10,000 to $50,000 ☐ $50,000 to $100,000 ☐ Over $100,000

10 Signature

11 Title (Not necessary if reporting personal account)

12 Date

PRIVACY ACT NOTIFICATION

Pursuant to the requirements of Public Law 93-579 (Privacy Act of 1974), notice is hereby given that the authority to collect information on Form 90-22.1 in accordance with 5 U.S.C. 552a(e)(3) is Public Law 91-508; 31 U.S.C. 1121; 5 U.S.C. 301; 31 CFR Part 103.

The principal purpose for collecting the information is to assure maintenance of reports or records where such reports or records have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings. The information collected may be provided to those officers and employees of any constituent unit of the Department of the Treasury who have a need for the records in the performance of their duties. The records may be referred to any other department or agency of the Federal Government upon the request of the head of such department or agency for use in a criminal, tax, or regulatory investigation or proceeding.

Disclosure of this information is mandatory. Civil and criminal penalties, including under certain circumstances a fine of not more than $500,000 and imprisonment of not more than five years, are provided for failure to file a report, supply information, and for filing a false or fraudulent report.

Disclosure of the social security number is mandatory. The authority to collect this number is 31 CFR 103. The social security number will be used as a means to identify the individual who files the report.